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DOCKETS

_____)	Docket Nos. OST-97-2881
Computer Reservations System)	OST-97-3014
(CRS) Regulations)	OST-98-4775
_____)	OST-99-5888

COMMENTS OF GALILEO INTERNATIONAL
IN RESPONSE TO
NOTICE OF PROPOSED RULEMAKING

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March 17, 2003

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Jerry Hausman, Effects of Orbitz (“Hausman Study”)

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**COMMENTS OF GALILEO INTERNATIONAL
IN RESPONSE TO
NOTICE OF PROPOSED RULEMAKING**

Galileo International L.L.C. (“Galileo”)¹ hereby submits its comments in response to the Department’s Notice of Proposed Rulemaking concerning computer reservations systems (“CRSs”), 67 Fed. Reg. 69366 (2002) (“NPRM”). In view of the Department’s proposals for very significant changes to the CRS rules – modifications that would largely eviscerate key features of the rules – it is essential that the Department evaluate thoroughly the impact of its proposals on airline competition, travel agents, consumers, and the public interest.²

¹ Galileo provides the Apollo CRS to travel agents located in the United States. Galileo offers CRS services on a global basis, with subscriber locations in 116 countries. Since October 2001, Galileo has been a wholly-owned subsidiary of Cendant Corporation (“Cendant”). Since the date Cendant acquired all of the Galileo stock, Galileo has had no airline owners. (United Airlines reportedly has sold the shares of Cendant stock it received as consideration for the sale of its interest in Galileo.) Galileo continues to have a marketing agreement with United.

² As Galileo has previously urged, the Department should hold a fact hearing to ensure a full exploration of all of the important facts relevant to this proceeding. The NPRM appears to rest on suppositions that lack appropriate factual support and to rely at some points on sources that are more than a decade old. See comments Galileo filed in support of Sabre’s petition for a fact hearing in this docket on January 3, 2003.

INTRODUCTION AND SUMMARY

The Department should retain an effective CRS regulatory framework so long as any CRS is owned or marketed by an airline or otherwise has an affiliation with an airline that will create incentives for anticompetitive conduct by the system or airline. Specifically, regulation should continue until all CRSs have been divested by their airline owners and all marketing agreements or other similar affiliations between CRSs and the airlines have terminated.

The CRS rules were originally adopted in response to abuses by airline owners of CRSs. Thus, in 1984 the Civil Aeronautics Board (“CAB”) imposed regulation of display bias, discriminatory booking fees, and use of marketing data in response to airline owners’ use of their systems to disadvantage their airline competitors. In 1992, the Department repromulgated and expanded the rules, based on similar concerns about anticompetitive conduct by airline owners. It added the mandatory participation rule (14 C.F.R. § 255.7) at that time because airline owners

With these comments, Galileo is submitting two independent studies, contained in a separately bound Appendix. The first – authored by three economists currently or recently affiliated with Economists Incorporated, all of whom have prior experience analyzing the CRS business – explains why certain proposals for change to the rules would have a negative effect on competition and consumers and should therefore be rejected and further explains that CRS booking fees are subject to competitive discipline. See Margaret Guerin-Calvert, I. Curtis Jernigan, & Gloria Hurdle, Economic Analysis of DOT Proposals to Change the CRS Rules (“EI Analysis”). The second study – authored by Jerry Hausman, Professor of Economics at the Massachusetts Institute of Technology – analyzes the anticompetitive impact of the airline-owned Orbitz joint venture, particularly the Most Favored Nations (“MFN”) clause used in Orbitz charter associate agreements. See Jerry Hausman, Effects of Orbitz (“Hausman Study”).

were withholding full participation from competing CRSs in order to enhance their positions in airline markets.

There remains a strong public interest in preventing an airline affiliated with a CRS from engaging in anticompetitive practices to advance the airline's interests. One of the traditional CRSs – Amadeus – continues to be majority owned by several large European carriers (Air France, Iberia, and Lufthansa), and another – Worldspan – is still wholly owned by three major domestic airlines (American, Delta, and Northwest). But the Department should look beyond mere ownership. Worldspan has announced that its airline owners will be selling their ownership interests to a non-airline company. It appears, however, that (assuming this transaction is completed) one or more of the Worldspan carriers will retain certain ties to the system, including marketing and other operating relationships and financial commitments, such as debt financing. Such affiliations can create incentives similar to those of ownership, *i.e.*, a strong incentive to favor Worldspan over competing systems. The current Worldspan owners could even enter into an explicit agreement to provide preferential access in the post-divestiture period. The Department should ensure that the rules prevent the Worldspan carriers from engaging in anticompetitive conduct arising from incentives created by any form of affiliation with Worldspan.

Moreover, the current Worldspan owners and two other major airlines are founding owners of Orbitz, an on-line reservations service that has recently begun to make its airline reservation services available to travel agents. The Orbitz owners, which represent about 72 percent of U.S. domestic air travel bookings (Hausman

Study , p. 2), are acting in a manner similar to the conduct that led to CRS regulation, using Orbitz and its agreements with other carriers to gain control over distribution and advance their airline interests. This is a situation that should concern the Department. Based on his analysis of the empirical evidence, Professor Hausman has found that “fare dispersion and the available quantity of lowest price airfares have decreased significantly since Orbitz began operation, which is the expected effect of the MFN clause contained in the Orbitz Agreement and which is harmful to consumers.” Id. at 3.

In these circumstances, the Department should retain all of the rules that it promulgated to protect against anticompetitive conduct by airlines with CRS affiliations. It should also extend the mandatory participation rule in several respects (including by extending the rule to carriers that have a marketing or similar affiliation with a CRS), so that it covers the full range of potential anticompetitive conduct.

The proposals for modifications to the rules constitute a very significant departure from the rules’ original purposes.³ The Department proposes to remove two important limitations on anticompetitive conduct by systems and their

³ As an ASTA official recently noted in discussing the NPRM, “[t]he well-documented history of the major airlines’ use of CRSs to handicap small airlines, travel agents and consumers is apparently being ignored.” See Paul M. Ruden, “Murphy’s Ticket Distribution ‘Next Steps’ Backwards,” Aviation Daily, Jan. 15, 2003, at 7.

Moreover, the proposals, if implemented, would be extremely disruptive. They would force a very substantial change in technical, financial, and legal relationships among CRSs, airlines, and travel agents. It does not appear that the Department (and the Office of Management and Budget) fully appreciate the magnitude of the changes they have proposed and the costs associated with disruption of the existing business model.

airline owners – the mandatory participation provision and the ban on discriminatory booking fees. Without these limitations, an airline with ties to a CRS would be free to make anticompetitive use of its system, to the disadvantage of lower cost and smaller airlines not affiliated with a system, and ultimately consumers.

Economists Incorporated, in an analysis included in the Appendix to these Comments, has concluded that, “[b]ecause the potential for discriminatory and anticompetitive conduct continues, these rules remain necessary.” EI Analysis, p. 2. As the authors of this analysis explain, “[e]limination of the mandatory participation and non-discriminatory pricing rules would pose substantial risks to competition. Their elimination would provide opportunities for the resurgence of higher charges for smaller airline competitors, which would increase their costs relative to those of larger airlines and disadvantage them in competition with larger airlines.” Id.

The NPRM proposals appear to be based on outdated and incorrect views of the CRS business. As demonstrated further below, changes in travel distribution have put heavy pressure on CRS booking fees, making it unnecessary to look for ways to give airlines more leverage in fee negotiations. The Department should reinstate its own earlier proposal to continue the mandatory participation rule and the prohibition against discriminatory booking fees. In addition, the Department should make clear that these and other CRS rules apply in the case of any affiliation that provides an incentive for the airline or the CRS to engage in anticompetitive conduct similar to the incentives created by CRS ownership.

The Department should also declare that the CRS rules apply to Orbitz and its airline owners in view of the facts that, as described below, Orbitz has begun

to make its airline booking services available to travel agents and is replicating the functionality of traditional CRSs. Orbitz presents competitive problems similar to those against which the CRS rules are intended to protect, and its airline owners should not be permitted to escape their obligations under the rules. The Department should enforce the existing rules, including the mandatory participation provision, against Orbitz and its owners.

The Department should also refrain from changing the rules that relate to subscriber contracts. Here, rather than deregulating (its asserted goal), the Department proposes to micromanage, imposing greater regulation on ordinary commercial practices that promote efficiency. There is no basis for doing so. In view of the fact that there is a high level of competition for subscribers and that travel agents have substantial bargaining power, there is no reason to interfere with commercial arrangements that have evolved under the current rules. Productivity pricing and similar volume-based discounts promote market efficiency and competition. As Economists Incorporated concludes, “[o]n balance, these payments are serving as an important means of competition among CRSs for travel agent subscribers.” EI Analysis, p. 4.

The proposed rules, if promulgated, would be contrary to the public interest. The proposed modifications appear to be deliberately skewed in favor of a few large airlines and airline-affiliated distribution systems (Amadeus, Orbitz, and Worldspan) and against airlines without CRS affiliations, non-airline-affiliated CRSs, travel agents, and ultimately consumers. These measures would open the door for the large airlines affiliated with Amadeus, Orbitz, and Worldspan to compel travel agents

and corporations to use the airline-affiliated CRSs to access these carriers' content, thereby increasing these carriers' dominance of air transportation markets.

The Department should not act based on a desire to help large airlines escape from their current financial woes, but instead should look to the original purposes of the CRS rules. Rather than adopting the modifications it proposes, the Department should continue the rules in their existing form, with extension of the mandatory participation provision to cover carriers with marketing and other affiliations with a CRS.

COMMENTS

I. EXISTING CRS REGULATION SHOULD BE CONTINUED AND STRENGTHENED SO LONG AS THERE ARE AFFILIATIONS BETWEEN AIRLINES AND CRSs.

The CRS rules were promulgated and subsequently extended and strengthened in order to prevent abuses by airline owners that were using their systems in an anticompetitive manner to further their airline interests at the expense of non-owner airlines. The CAB in 1984 imposed restrictions on display bias, discriminatory booking fees, and use of marketing data, addressing specific practices airlines had used to disadvantage their competitors. In 1992, the Department repromulgated the CRS rules, based on similar concerns about anticompetitive conduct by airline owners. See 68 Fed. Reg. 7325 (2003) (noting that Department found in 1992 that the CRS rules "were necessary to ensure that each of the airlines and airline affiliates that controlled a system did not use the system to unfairly prejudice the competitive position of other airlines and to ensure that travel agents

and their customers could obtain accurate and unbiased information from the systems”). At that time the Department added the mandatory participation rule (14 C.F.R. § 255.7) because airline owners were withholding full participation from competing systems in order to enhance their positions in airline markets. See 57 Fed. Reg. 43780, 43800-01 (1992).

Today CRSs continue to be owned or marketed by airlines, and the airlines with CRS affiliations still have an incentive to misuse their systems to advance their airline interests.⁴ Affiliations between airlines and CRSs take several different forms, and new forms may emerge in the near future. One of the traditional CRSs – Amadeus – is partially owned by Air France, Iberia and Lufthansa – and another – Worldspan – is wholly owned by three major U.S. airlines – American, Delta, and Northwest. American and Southwest Airlines have marketing relationships with the Sabre system, and United has a marketing relationship with Galileo. The Worldspan owners, along with Continental and United, are founding owners of Orbitz, an on-line reservations service that has recently begun to make airline reservations services available to travel agents.

Other types of relationships between airlines and CRSs may develop. Worldspan has announced that its airline owners will sell their ownership interests to a non-airline company. However, it appears that one or more of these carriers may

⁴ As used in these comments, the terms “affiliation” and “affiliate” refer to a range of relationships that create incentives for anticompetitive conduct similar to the incentives created by airline ownership of a CRS. Thus, reference to an “airline-affiliated CRS” or “affiliated carrier” would encompass marketing, financial, or operating affiliations that create incentives to distort competition.

retain not only marketing and operating relationships with Worldspan, but also some form of financial interest, perhaps in the form of provision of debt financing. Any such affiliation could give an airline an incentive to favor the CRS in a manner that will serve its airline interests. As Amadeus noted in a 1999 filing in this docket, airline “control” of a CRS is not necessary to implicate the concerns underlying the CRS rules. “Rather, it is the airline’s financial interest that carries with it the incentive to distort CRS competition in the air service markets in which the airline is dominant. . . .” See Supplemental Reply Comments of Amadeus Global Travel Distribution, S.A., Docket Nos. OST-97-2881 et al., filed Dec. 13, 1999, at 4 (emphasis in original). As Amadeus suggested, the focus must be on whether there is a business incentive to favor the affiliated CRS over its competitors.

Large airlines affiliated with CRSs continue to act in an anticompetitive manner with respect to distribution. As discussed in the following section, the Department has concluded that airlines affiliated with CRSs continue to withhold participation in competing CRSs. In addition, the major airlines that own Orbitz are operating it with the apparent goal of gaining control of and distorting distribution and advancing their airline interests. As Professor Hausman shows, Orbitz, with its use of MFN clauses, has already had a measurable anticompetitive impact on the air transportation marketplace. See Hausman Study, pp. 10-11; see also Part V below.

Because airlines still use their affiliated CRSs in an anticompetitive manner to further their airline interests, and because such conduct harms non-affiliated carriers and, ultimately, consumers, it is in the public interest to retain the

existing CRS rules. Contrary to the Department's suggestion, withdrawal of certain rules (as proposed by the Department) is not necessary to control the level of booking fees. Economists Incorporated, based on their review of current market conditions and the rationale for CRS regulation, confirm that the Department should retain the mandatory participation provision and the prohibition of discriminatory booking fees.

The authors state:

Basic regulations continue to be required to protect both consumers and non-owner (unaffiliated) airlines. Airlines have recently demonstrated their ability to negotiate reduced booking fees from CRSs under the current regulatory scheme, including the mandatory participation and non-discrimination rules. The fundamental principles of regulation should continue to govern traditional CRSs and their relationships with other market participants and should also be applied to evolving entities that are the functional equivalent of CRSs and therefore have the capability to engage in the types of anticompetitive behavior that the CRS regulations seek to deter.

EI Analysis, pp. 4-5.

In proposing significant changes to the rules that are skewed in favor of large airlines, the Department may be influenced by the fact that these airlines are in serious economic trouble, due in part to recession and the aftermath of September 11. But CRS regulation should not turn on the circumstances of the moment. Over the past five years the Department repeatedly concluded that the basic CRS regulatory framework should remain in place while the Department monitored developments in travel distribution. That continues to be the sensible course. Travel distribution is still evolving, and the need for the protections afforded by the rules still exists. Rather than casting protections aside in a misguided effort to help large

carriers return to profitability, the Department should remain true to its original purpose in promulgating the rules and retain and strengthen the existing regulatory framework.

The threat to competition and consumer welfare that is posed by affiliations between airlines and CRSs remains so long as any CRS (including Orbitz) is owned by, marketed by, or otherwise affiliated with, an airline. Until all such affiliations between airlines and CRSs have ended, the public interest requires that the Department continue to enforce rules that effectively govern the conduct of airlines and their affiliated systems.

II. THE MANDATORY PARTICIPATION RULE SHOULD BE PRESERVED AND STRENGTHENED.

The most significant flaw in the NPRM is the proposal to eliminate Section 255.7, the rule that currently requires a system owner to participate in other CRSs at the same level as it participates in its own system and to provide information on its fares and schedules to other CRSs to the same extent it provides such information to its own system. This rule prevents airline owners of CRSs from reducing their participation levels in other systems to make those systems less attractive to travel agents (particularly to those agents located in one of the owner's fortress hubs), effectively forcing agents to use the owner's system and forcing all airlines to participate in that system.

In its Draft Notice of Proposed Rulemaking Originally Submitted to OMB for Review, dated April 11, 2002 ("April 11 Draft"), the Department concluded that the mandatory participation rule should be preserved and expanded to cover

marketing carriers and to prohibit tying of corporate discount fares to choice of a CRS. However, the Office of Management and Budget (“OMB”) directed that the provision be removed in its entirety.⁵

The Department’s original judgment was plainly correct and is supported by the record. The mandatory participation rule should be retained and expanded in order to reach the full range of anticompetitive conduct.

A. The Rule Is Needed To Prevent Abuse By System Owners.

Two of the four traditional CRSs operating in the United States – Amadeus and Worldspan – as well as the newest entrant, Orbitz, are owned in whole or in part by large airlines.⁶ Eliminating the mandatory participation rule will allow these airlines to engage more freely in abuses that will have an immediate negative impact on airlines not affiliated with a CRS (particularly low cost and smaller carriers), travel agents, and consumers.

In proposing extension of the CRS rules in 1992, the Department noted that “the competitive problems of concern to us largely stem from the existing

⁵ OMB apparently directed the Department to propose withdrawal of the mandatory participation rule after large airlines lobbied OMB on this issue. See 67 Fed. Reg. at 69367. Respectfully, OMB lacks the expertise to overrule the Department’s judgment that there is a continuing need for regulation on this subject. Moreover, ignoring historical lessons and the judgment of the Department’s experts on this issue is inconsistent with sound public policy. At the same time, as explained below, it is doubtful that the removal of mandatory participation will further any significant governmental interest that OMB may have been attempting to promote; instead, this step will likely harm consumers.

⁶ Orbitz, which is owned by five airlines representing 72 percent of the U.S. market, is now making its airline booking services available to travel agents and thus qualifies as a CRS. See Part V below.

systems' control by airlines, who can use that control to prejudice the competitive ability of other airlines." 56 Fed. Reg. 12604 (1991). As the Department recognized when it promulgated the mandatory participation rule in 1992, a system owner's reduction of participation in competing systems for strategic reasons creates significant competitive problems. See 57 Fed. Reg. at 43800. For example, where an airline that dominates a hub refuses to participate fully in a CRS, travel agents are likely to conclude that they cannot afford to use that system, since for competitive reasons they must carry the full content of the dominant carrier in their market. The result is that the dominant airline's system gains an even stronger position. See id.

The threat of such anticompetitive conduct is not merely hypothetical. In proposing the mandatory participation rule in 1991, the Department cited several instances in which airline owners of CRSs were reported to have limited their participation in competing systems in order to compel travel agencies to choose systems affiliated with those airlines. See 56 Fed. Reg. at 12608.

Galileo has been the target of such anticompetitive conduct, even with a rule in place. Following promulgation of the mandatory participation rule in 1992, a Galileo predecessor tried repeatedly to persuade Northwest to participate at the highest level in the Apollo system,⁷ the level equivalent to Northwest's participation level in Worldspan. These efforts consumed more than a year and a half. Northwest ultimately agreed to participate in Apollo at the highest level only after the Department threatened enforcement action. Later, both Northwest and American

⁷ The Apollo system is the CRS Galileo provides to travel agents located in the United States. See page 1 note 1, supra.

delayed participation in the new Inside Availability level in the Apollo system.

Galileo believes that informal pressure from the Department finally persuaded these carriers to sign up for Inside Availability. In the meantime, however, these carriers were able to gain an artificial competitive advantage in key markets.

In 1997, when it promulgated a rule banning parity clauses, the Department cited evidence of similar strategic conduct. This included Sabre's assertion that some South American airlines had reduced their participation in Sabre in order to create an advantage for the Galileo system, which these airlines marketed. See 62 Fed. Reg. 59784, 59797 (1997).

Most recently, when it sent its proposed rules to OMB, the Department explained that it was proposing to maintain the mandatory participation rule based on its experience that airlines owning or marketing a system have at times limited their participation in competing systems in order to compel travel agencies to choose systems affiliated with those airlines. See April 11 Draft, p. 51. The Department pointed out that such conduct reduces air transportation competition, as well as CRS competition, noting that "an airline's success in increasing the market share of its affiliated system at its hubs will likely further strengthen the airline's dominance of the local airline markets, thereby reducing competition in the airline industry." Id. at 52.

There is no evidence to suggest that airlines affiliated with CRSs have less incentive to engage in such tactics now than they did before. The airline owners of Worldspan – Northwest, Delta, and American – all have strong positions in

“fortress” hubs.⁸ History has demonstrated that they are likely to make strategic use of CRS participation in markets such as Minneapolis, Detroit, Atlanta, and Dallas. See, e.g., 56 Fed. Reg. at 12608 (citing complaints that Northwest had restricted its participation in other CRSs in order to force agencies at Northwest hubs to become PARS subscribers).⁹

In the future it is likely that the current Worldspan owners will once again perceive that it is in their interests to withhold participation and/or inventory from competing CRSs. (As noted above, even if these carriers sell their ownership interests in Worldspan, they presumably will retain other affiliations that give them a vested interest in the system.) In view of the roughly 50 percent share of U.S. transportation held by American, Delta and Northwest, and the network dominance these carriers possess collectively, other CRSs could not compete if they did not have

⁸ Based on CRS bookings in September 2002, Delta enjoyed over 83 percent of the bookings made by Atlanta travel agencies and over 93 percent of the bookings made by Cincinnati travel agencies. In the same period, Northwest enjoyed over 74 percent of the bookings made by Detroit travel agencies, over 75 percent of the bookings made by Memphis travel agencies, and over 75 percent of the bookings made by Minneapolis travel agencies.

⁹ These carriers have shown that they are prepared to defy the Department. For example, Northwest and Delta, (along with Continental) recently announced that they would implement their alliance arrangement without regard to conditions the Department had prescribed and regardless of whether the Department institutes an enforcement action. See Letter of Rebecca G. Cox, Scott Yohe, and Andrea Fischer Newman to Honorable Read Van de Water, Jan. 21, 2003; “Continental, Delta and Northwest Will Implement Alliance Agreement,” Press Release, Jan. 21, 2003. While the carriers have apparently continued to negotiate with the Department, they have not rescinded their threat to proceed without the Department’s approval.

full participation of the three carriers.¹⁰ As competing CRSs are marginalized or driven out of business, travel agencies will have fewer CRS choices. And, as Worldspan faces less competition, it will likely reduce its investment in technology and innovation, relying on preferential access to content of its affiliated carriers, rather than competition on the merits.

The potential adverse impact on low cost and other smaller carriers in these fortress hubs is quite substantial. For example, without mandatory participation, the Worldspan carriers could withdraw from, or reduce their levels of participation in, competing CRSs. As a result, travel agents in a market such as Atlanta or Detroit would have little choice but to sign up to use Worldspan to access these carriers' content. Once most travel agents in the area subscribed to Worldspan, carriers not affiliated with Worldspan (especially low cost and other smaller carriers) would fall victim to any anticompetitive conduct by Worldspan. For example, in order to preserve and enhance Delta's position in Atlanta, Worldspan could find ways to delay provision of enhancements to AirTran or (if the prohibition against discriminatory booking fees were removed) charge AirTran exorbitant fees in order to distribute its inventory. AirTran would quickly lose its operating cost advantage, effectively eliminating it as a low-cost competitor for Delta and an alternative for consumers in the Atlanta market.

¹⁰ CRSs without airline affiliates would be particularly disadvantaged if the mandatory participation rule were eliminated. If there is no constraint on the conduct of affiliated airlines, those airlines will be free to withhold participation in non-airline-affiliated CRSs; however, the non-airline-affiliated systems and non-CRS-affiliated airlines will have no comparable distribution weapon.

The analysis of the Department's proposals conducted by Economists Incorporated explains the significant risk that repeal of mandatory participation would lead to anticompetitive conduct. The authors observe that "[t]he incentives of an airline to favor its affiliated CRS and the incentives of a CRS to favor its affiliated airline(s) remain strong" and that the competitive risks previously identified by the Department "remain, and indeed, may be somewhat enhanced, by current marketplace developments." EI Analysis, p. 71. For this reason, the authors conclude that the current mandatory participation rule should be retained. Id.

The increase in dominance by major carriers at the expense of new entrants and other low cost carriers due to withdrawal of the mandatory participation rule will inevitably harm consumers. As the large carriers reinforce their dominance, they will be in a position to increase fares, while the low cost carriers will be marginalized or frozen out entirely. Thus, consumers will have fewer airline choices and face higher fares. This is precisely the sort of abuse the CRS rules were designed to prevent.¹¹

Without the mandatory participation rule, the potential for such abuse would increase in at least the hub markets dominated by the airline affiliates of Worldspan and Orbitz, threatening a number of low cost carriers and potential low cost entrants. In addition, based on the conduct of the Amadeus carriers in Europe, Galileo believes there is a significant threat that these carriers would engage in

¹¹ Not only should the Department retain the mandatory participation rule and other rules protecting against airline abuses, it should develop an effective way to police such abuses and to bring enforcement actions under Section 411, 49 U.S.C. § 41712, where appropriate.

anticompetitive conduct in this country in the absence of the mandatory participation rule.¹² Because of the potential for abuse by parent carriers, a number of European airlines not affiliated with CRSs (including British Airways, KLM, British Midlands, Alitalia, SAS, and Swiss International) have argued strongly in favor of preserving mandatory participation in the European Union. The Amadeus carriers, on the other hand, take the opposite position.

As an alternative to the existing mandatory participation rule, the Department suggests that it could establish a presumption that a system owner's refusal to participate in competing CRSs at the same level as it participates in its own system is designed to restrict competition if the terms offered by the competing system are commercially reasonable. See 67 Fed. Reg. at 69394. This is not a satisfactory alternative. As described above, even with a very clear rule on the books since 1992, it has been difficult for Galileo to persuade several system owners to participate at the appropriate levels in the Apollo system. These system owners offered various excuses, but the Department rejected such excuses. Replacing an explicit requirement with a presumption will simply encourage airlines affiliated with

¹² For example, Iberia does not provide real-time availability to Galileo and will not allow systems other than Amadeus to issue prepaid tickets, ticket on departure, or make group bookings. The European Commission has taken action against Air France for failure to cooperate with a U.S.-based CRS, and the Department has acted against Iberia based on its failure to participate fully in U.S.-based systems. See "New U.S.-EU Antitrust Pact Is Used to Prod Air France Into Working With SABRE System," Antitrust & Trade Regulation Report (BNA), vol. 79, no. 1969 (July 28, 2000); Dockets 48654, 48655, Complaint of American Airlines v. Iberia, Lineas Aereas de España et al., Order 93-2-37 (Feb. 17, 1993).

a CRS to offer more pretextual excuses to withhold participation in competing systems.¹³

B. The Department Should Clarify Or Extend The Rule In Several Respects.

The Department should clarify or extend the coverage of the rule in certain respects. This is particularly important in view of the recent announcement that the Worldspan owners plan to sell their ownership interests in that system.

First, there can be no question that the Department should extend the rule to cover airlines that market a CRS. The Department has long recognized that airline marketers of a system can engage in the same sort of strategic limitation of participation in competing systems as system owners. In 1997, the Department created an exception that permitted parity clauses for system marketers as well as system owners. It did so because it understood that “the same incentive to downgrade participation in competing systems could well exist in an airline that is marketing a system.” 62 Fed. Reg. at 59797.

More recently, in its April 11 Draft, the Department suggested that the mandatory participation rule should cover airlines that market CRSs. The Department again noted that a marketing airline “will have substantial incentives to limit its participation in competing systems in order to undermine their ability to compete for travel agency customers,” and that this “can distort competition in the CRS business just as much as a system owner’s refusal to participate in competing

¹³ The Department recognizes that a presumption would require it to resolve difficult issues of intent. 67 Fed. Reg. at 69394.

systems.” April 11 Draft, p. 54. The Department further noted that it would be difficult to maintain a mandatory participation rule for airlines with an ownership interest when airlines marketing a system remained free of such a requirement. Id.

The Department’s original judgment with regard to marketing carriers is consistent with the evidence and is entirely appropriate.

Second, the Department should extend the mandatory participation rule to carriers that have any form of relationship with a CRS that would provide an incentive to distort competition. The recent announcement that American, Delta, and Northwest intend to divest their ownership interests in Worldspan makes it particularly important to have a rule that will place limitations on airlines that have any type of affiliation with a CRS. Worldspan and its owners have been secretive about the terms of the divestiture agreement they have negotiated.¹⁴ However, Galileo understands that one or more of the carriers will maintain ongoing marketing, operating, or financial relationships with Worldspan that will give them a stake in its success and thus provide an incentive for anticompetitive conduct with respect to competing systems.

It is even possible that the current owners will agree to provide Worldspan with enhanced participation levels or preferential access to their inventory following the announced divestiture as a condition to sale. While they would no

¹⁴ In connection with this proceeding, the Department should require Worldspan and its owners to disclose the terms of the divestiture, including any continuing affiliations between the airlines and Worldspan in the post-divestiture period. Such information is important to the consideration of what regulatory scheme is appropriate.

longer be system owners under the definition in the current rules, these carriers should not have the option of promising preferential access as a way to obtain a higher sale price or other more favorable terms associated with the Worldspan business.¹⁵

Even apart from an explicit promise to provide preference to Worldspan, the carriers could maintain many types of ties that would give them a strong incentive to favor Worldspan over competing systems.¹⁶ The Department should expand the scope of the mandatory participation rule to ensure that the current Worldspan owners are not in a position to distort competition in this manner following divestiture.

Third, the Department should make clear that the mandatory participation rule prohibits an airline's tying of access to its corporate discount fares

¹⁵ American, Northwest, and Delta and any Worldspan purchaser could conclude that they would realize greater value if all three selling airlines agreed to reduce their participation in other systems, perhaps to the point of withdrawing from Amadeus and/or Galileo within a few years of the sale. The Department should make clear that the mandatory participation rule would prohibit such a strategy.

¹⁶ In analyzing the need for continued CRS regulation, Economists Incorporated notes:

The announced sale of Worldspan to non-airline owners does not fundamentally alter the need for continued CRS regulation or mitigate the need for maintaining regulations such as mandatory participation and non-discriminatory pricing. . . . [T]here remains the prospect that affiliated airlines – i.e., those having marketing or other financial or operating affiliations with a CRS – would have the incentive and ability to engage in actions that would distort airline competition if unregulated.

to use of its affiliated system. In Docket No. OST-99-5888, both Amadeus and Galileo cited instances of travel agents being pressured to use systems owned by carriers that dominated the service offered at a particular hub, through those carriers' refusal to provide their corporate discount fares through competing systems.

These tying practices continue today. Recently a senior executive of a large multinational travel agency informed Galileo that 10 percent of his agency's travel volume (approximately two million of a total 20 million segments per year) is covered by contracts between an airline and a corporation that require use of the airline's affiliated CRS to obtain a deeper discount from that airline. Such arrangements effectively preclude competition by other CRSs for that very substantial volume of business. Another example is Northwest's arrangement to provide a Fortune 100 corporation with a two percent discount on airfares if Worldspan is used to make the booking.¹⁷ This arrangement made it virtually impossible for any non-Worldspan agency to compete when that corporation recently put its travel business out for bid.

In the April 11 Draft, the Department cited similar evidence submitted by SystemOne and Galileo, widespread complaints from travel agents themselves, and cases in which a corporation was unable to use its preferred travel agency due to a carrier's tying of corporate discounts to a CRS other than that used by the agency. See April 11 Draft, p. 55. The Department concluded that tying of corporate discount fares to use of an airline's affiliated system "is an effective competitive weapon

¹⁷ According to information Galileo receives, the current Worldspan owners are the airlines that most often enter into such tying arrangements.

against rival systems” and occurs where a carrier’s dominance of the local airline market leaves travel agencies and corporate customers without meaningful alternatives. Id.

The record fully supports a prohibition on an airline’s tying of corporate discount fares to use of the CRS with which it is affiliated. The mandatory participation rule already prohibits such tying where a fare is “commonly available to subscribers” to the airline’s own system. 14 C.F.R. § 255.7(b). In addition, 14 C.F.R. § 255.8(c), which states that “[n]o system owner may require use of its system by the subscriber in any sale of its air transportation services,” is broad enough to reach tying of any discount fare and use of a particular CRS. The Department should make clear that the mandatory participation rule and Section 255.8(c) together bar an airline’s tying of corporate discount fares to use of its affiliated system. Alternatively, the rules should be expanded to accomplish this result.

C. The Rules Should Permit Parity Provisions For Any Carrier Affiliated With A CRS.

Since 1997, the CRS rules have included a provision banning so-called “parity” provisions (i.e., contractual requirements that a carrier participate in a system at the same level at which it participates in any other CRS), except in the case of carriers that own or market a system. 14 C.F.R. § 255.6(e). The Department states that it is inclined to retain the prohibition on parity provisions, but that it may eliminate the exception for system owners and marketers if the mandatory participation rule is removed. 67 Fed. Reg. at 69392.

The exception to the parity provision rule for carriers affiliated with a CRS should be retained for the same reasons that the mandatory participation rule should be continued.¹⁸ A CRS should be able to protect itself contractually against efforts by carriers affiliated with competing systems to disadvantage it. Presumably such carriers have ample bargaining leverage to negotiate reasonable terms as part of such a contractual arrangement. Indeed, the large carriers that are affiliated with CRSs presumably can bargain for a quid pro quo in exchange for inclusion of the parity provision.

Absent some significant countervailing interest, parties should be free to bargain for contract terms that meet their business interests. There is no good reason to bar a CRS and carriers affiliated with a competing system from negotiating a parity provision if they wish to do so.¹⁹

¹⁸ As with mandatory participation, this exception should be broadened to cover all affiliations between an airline and a CRS that could provide an incentive for anticompetitive conduct. Alternatively, the Department could interpret the term “marketing carrier” broadly to include all such affiliations.

¹⁹ The NPRM also proposes to prohibit a system from conditioning a carrier’s participation on access to fares that the carrier has chosen not to sell through any other system. See 67 Fed. Reg. at 69393. The Department also suggests denying a CRS the ability to prohibit a carrier from discriminating against it if the difference in treatment is due to higher booking fees or poorer service, unless that carrier is an owner or marketer of another CRS. See id. If the Department adopts this proposal, it should include an exception for carriers affiliated with a CRS, since those carriers are more likely to withhold inventory for anticompetitive purposes. Such carriers can be protected through the “commercially reasonable” term of the mandatory participation rule.

III. THE PROHIBITION ON DISCRIMINATORY BOOKING FEES SHOULD BE RETAINED.

The NPRM proposes to eliminate the prohibition against discrimination in CRS booking fees, now embodied in 14 C.F.R. § 255.6(a). It suggests that booking fees have not been significantly disciplined by competition and may exceed system costs. 67 Fed. Reg. at 69370, 69383, 69398. The Department suggests that the current ban on discrimination in fee levels limits the ability of carriers to negotiate for better terms.

While Galileo does not depend on the prohibition, and believes it could compete effectively without it, the prohibition should be retained so long as there are airline-affiliated CRSs.²⁰ Ending the ban on discriminatory fees is likely to disadvantage smaller carriers, which have the least bargaining power and will end up subsidizing the larger carriers. Ultimately consumers will suffer. This runs counter to the Department's desire, stated in the preamble, to create a marketplace that benefits small carriers and consumers.

As a general principle, Galileo believes that regulations restricting commercial operations should be eliminated unless there is strong need for them. In

²⁰ Unless the Department retains the prohibition on discriminatory booking fees, it should eliminate the existing requirement that a CRS disclose its fees to all participants. If there is no nondiscrimination requirement, there is no reason to force parties to an individually-negotiated contract to disclose to third parties the terms they have negotiated. Such disclosure is not only contrary to ordinary business practices; it may have ancillary anticompetitive effects of stabilizing price levels that competing carriers pay and that competing CRSs charge. It may also limit the flexibility and innovation in the terms that parties (particularly smaller airlines that are not affiliated with a CRS) might otherwise negotiate.

the case of the prohibition on discriminatory fees, however, as in the case of the mandatory participation rule, there is such a need.

The CAB originally promulgated the ban on discriminatory pricing because, in the pre-rules period, booking fees charged to some carriers were very high relative to the fees charged to others for the same service. See 57 Fed. Reg. at 43784 (noting that some carriers paid as much as \$3 per booking while others paid as little as 30 cents). There is no reason to think that history would not repeat itself if the ban on discriminatory pricing were removed. Larger carriers are more attractive to CRSs (in part because more travel agents desire access to their inventory) and thus have greater leverage to demand a low fee. Smaller carriers, on the other hand, have less leverage and would pay much higher fees, subsidizing the low fees paid by the large carriers.²¹ Moreover, airline-affiliated CRSs could use higher booking fees as a competitive weapon to drive up costs of the direct competitors of their airline affiliates.

Such a result could have a devastating impact on competition in air transportation markets. New entrants would be particularly vulnerable. The existence of some of these carriers would be at risk if CRSs were free to impose higher fees on them to make up for lower fees demanded by major carriers.

²¹ As Economists Incorporated explains, the ban on discriminatory fees permits smaller carriers to benefit from any lower fees or other improvements in terms that larger carriers are able to negotiate. See EI Analysis, p. 60. Thus, the rule can help to keep CRS booking fees low for all carriers, not just those with the greatest bargaining power. This procompetitive feature has undoubtedly helped low cost and smaller carriers to develop successfully over the past two decades.

The adverse consequences to low cost and smaller carriers would be especially severe if non-discriminatory pricing were eliminated and there were no mandatory participation provision. Low cost and smaller carriers could be held hostage by CRS-affiliated carriers, which could arrange for the low cost and smaller carriers to pay a premium to participate in their system, while the affiliated carriers pull out of competing systems. As discussed earlier, small carriers like AirTran in Atlanta would have no choice but to distribute through the airline-owned CRS in owner hub markets, and could end up paying egregiously high fees or be forced to drop out of the market, limiting airline competition. Further, small and low cost carriers would lose the ability to offer low prices to consumers and cancel their plans for expansion, as they lost access to capital. Ultimately, the CRS-affiliated carrier would act as a toll collector to levy a supracompetitive price against its competitors, thereby increasing its hub market dominance.

Economists Incorporated explains the anticompetitive consequences of withdrawing both the mandatory participation provision and the ban on discriminatory fees.

[W]e would expect, if the repeal of the rules had an effect on the relative bargaining positions of the airlines and CRSs, the result would be that large airlines would pay lower booking fees than smaller airlines – not because the costs of serving the larger airlines are necessarily lower, but because they have the ability to make a CRS less attractive by reducing their participation in that system. . . . [T]here is no reason to believe that eliminating the two rules would benefit smaller airlines in absolute terms, and it seems, if anything, likely to make them worse off in relative terms. It is clear that such an outcome would not

promote the competition in air transportation markets that the DOT seeks.

EI Analysis, p. 65. Economists Incorporated sums up the likely effect of withdrawing the two rules as follows:

Elimination of the mandatory participation and non-discriminatory pricing rules would pose substantial risks to competition. Their elimination would provide opportunities for the resurgence of higher charges for smaller airline competitors, which would increase their costs relative to those of larger airlines and disadvantage them in competition with larger airlines. Moreover, elimination of mandatory participation rules could provide opportunities for airlines affiliated with CRSs to withhold inventories from competing CRSs, thereby potentially reducing inter-CRS competition to the detriment of consumers and airlines.

Id. at 2-3.

It is plainly in the public interest to retain the prohibition against discriminatory booking fees, as well as a comprehensive mandatory participation provision.

IV. THE DEPARTMENT FAILS TO JUSTIFY WITHDRAWAL OF THE MANDATORY PARTICIPATION RULE AND THE PROHIBITION ON DISCRIMINATORY BOOKING FEES.

The rationale the Department offers for removing the mandatory participation rule and the ban on discriminatory fees fails to justify these proposals. According to the NPRM, removal of these rules will provide airlines with more bargaining leverage, which should allow them to negotiate lower booking fees. See 67 Fed. Reg. at 69394, 69399. This rationale does not make sense. Contrary to the Department's assumption, airlines do in fact have substantial leverage with respect to

CRS booking fees. Moreover, there has been no showing that CRS booking fees are at a supracompetitive level.²²

Based on their investigation of the empirical evidence, Economists Incorporated sums up the reasons why the Department's rationale is flawed:

Claims about high booking fee levels or the relative costs of distribution through CRSs as compared to online channels should not be used as a basis for elimination of the mandatory participation or non-discrimination rules. In particular, estimates of changes in booking fees over time tend to overstate the increases in fees relative to system functionality and, specifically, do not account for underlying improvements in CRS services or technology and the increasing complexity of fares. Booking fees are subject to important constraints from non-discrimination regulation and competitive pressures. The CRS industry appears to be responding in a competitive manner to these pressures and demands of its airline and travel agent constituencies.

EI Analysis, p. 57.

²² The premise that the mandatory participation rule keeps booking fees high is simply wrong. The rule states that a system owner shall participate in another CRS only if the terms are "commercially reasonable." 14 C.F.R. § 255.7(a). If in fact the fee for a particular participation level (*i.e.*, the same level as the one at which the system owner participates in its own system) is supracompetitive, then the system owner could decline to participate and demonstrate to the Department that the fee was unreasonable. So far as we are aware, no system owner has ever attempted to make such a showing to the Department, much less succeeded in doing so -- a good indication that the fees charged by Galileo and others are not unreasonably high but rather are commensurate with the value provided to airlines. In any event, the "commercially reasonable" standard provides ample protection for airlines affiliated with a CRS, and should provide them with whatever leverage they need to negotiate about fees.

A. The Level Of Airline Booking Fees Is Subject To Competitive Discipline.

Contrary to the Department's suggestion, CRSs have never been able to increase booking fees at will. As explained by Economists Incorporated, CRSs have always been dependent on participation by airlines, particularly large airlines. EI Analysis, pp. 12-13. If a CRS cannot offer the inventory of even one major carrier, it will have great difficulty winning travel agent subscribers. See id. at 12 ("Just as it is competitively important to an airline to participate in each CRS, it is competitively important to a CRS to have each airline participate in its system. . . . If a CRS did not have the participation of a major airline, that CRS would not have content comparable to its competitors and would not be able to meet the demands of travel agent subscribers.") CRSs know that if they increase airline booking fees too much, they run the risk that one or more carriers will drop out. This is a highly effective constraint on booking fee levels.²³

Moreover, industry developments in recent years have increased the extent to which booking fees are subject to competitive discipline. As a result of technological developments, there are many distribution channels in addition to CRSs. The internet has changed patterns of behavior in this area, as in many others. Airlines themselves have made concerted efforts to shift business away from the traditional agency channel, by promoting on-line booking through their own web sites and by withholding content (particularly discounted web fares) from CRSs.

²³ The fact that the Department found it necessary to impose the mandatory participation rule in 1992 in itself indicates that it is airlines that have market power vis-à-vis CRSs, not vice versa.

As a result, there have been dramatic shifts in use of distribution channels. Table 1 shows the shift between 2000 and 2003, based on information available to Galileo.

Table 1 Market Share by Channel				
	2000	2001	2002	2003
Offline Agency	68.6%	63.3%	58.0%	54.3%
DirectConnect to Supplier	---	---	0.2%	1.5%
Online Agency	7.1%	10.0%	14.7%	16.6%
Total Agency Market	75.7%	73.3%	72.9%	72.4%
Offline Supplier Direct	17.5%	18.7%	17.0%	16.5%
Online Supplier Direct	6.8%	8.0%	10.1%	11.1%
Total Supplier Direct	24.3%	26.7%	27.1%	27.6%

As more and more business flows through channels that do not include a CRS — e.g., individual airline web sites or an airline's direct connections to a corporation or travel agency — the airlines become less dependent on CRSs. Moreover, as technology advances, even traditional travel agencies have developed the ability to bypass CRSs for some transactions. In a move to bypass CRSs, many airlines have set up web sites to service a travel agent directly. A traditional travel agency may use an integrated direct connect provider such as Navitaire to bypass a CRS for many routine transactions. An airline that wishes to reduce its level of CRS participation, or to withdraw from a particular CRS entirely, knows that travel agencies will continue to have the ability to book its flights.

Airlines have not been reluctant to use their increased leverage relative to CRSs. Through Orbitz, the on-line reservations system they created, five large U.S. airlines obtained booking fee rebates from Worldspan for bookings made

through Orbitz. Some of the Orbitz owners are also bypassing Worldspan through use of direct connections with individual airlines.

In addition, as discussed in Part V below, most airlines have declined to provide CRSs with their attractive web fares, despite significant incentives from CRSs to do so. This concerted refusal to provide all CRSs access to valuable public fare inventory, facilitated by the Orbitz airline contract provisions, makes CRSs less attractive relative to Orbitz and the airlines' own web sites. As described at pages 42-44 below, Orbitz has begun to market its services to travel agencies through the use of Navigant's AQUA software, allowing agents to obtain access to web fares that are not available to traditional CRSs.

CRSs, especially systems not owned by any airline, have responded to these competitive pressures.²⁴ Within the past year, both Sabre and Galileo have introduced programs under which an airline that provides all of its public inventory to the CRS will receive a 10 percent discount on all its bookings in that system.

More recently, Galileo launched its Momentum program, under which an airline that provides its entire public inventory of fares to Galileo will receive a discount of approximately 20 percent on fees for bookings made through participating agencies and will face no booking fee increases for a three-year period.²⁵ A travel

²⁴ Galileo understands that Amadeus, a system that still has airline owners, has the highest booking fees. See <http://www.americanairlines.com/content/agencyPrograms/everyfare/programOverview.jhtml>.

²⁵ Thus far, only two carriers (United and US Airways) have agreed to join this program, despite Galileo's efforts to recruit others. This limited response suggests that carriers are not that interested in reduced booking fees or that they expect to use their leverage to obtain even more favorable terms.

agency that participates in the program commits to a reduction in its financial assistance in exchange for access to this inventory and other benefits.²⁶ These fee concessions from Galileo and the agencies allow airlines to obtain a discount of \$1.00 per booked segment. The Momentum program brings all the parties together in a give and take scenario, which should address many concerns airlines have raised about CRS fees and about the impact of financial assistance to travel agent subscribers. As Economists Incorporated notes, the ability of airlines to negotiate substantial reductions in booking fees in exchange for provision of web fares to CRSs “indicates that airlines have bargaining leverage over CRSs and that such leverage has been exercised by major airlines under the current CRS rules (e.g., mandatory participation and non-discrimination rules).” *EI Analysis*, pp. 45-46.

Based on their review of current market conditions, Economists Incorporated concludes that

recent substantial discounts negotiated between major CRSs and airlines show that airlines are able to impose significant competitive discipline on CRSs. CRSs are constrained by the need to maintain volumes and to expand share in order to increase revenues and profits. This is particularly the case for the unaffiliated CRSs. A review of dramatic changes in CRSs in recent years — including product enhancements and substantial expansion of content and suppliers — demonstrates that CRSs are being responsive to the demands of their customers and expending substantial resources to meet their needs.

²⁶ Travel agencies representing approximately 25 percent of the volume of bookings through the Apollo system have agreed to participate in the Momentum program.

EI Analysis, p. 56. Economists Incorporated concludes that booking fees “are subject to important constraints” and that CRSs “appear[] to be responding in a competitive manner to these pressures.” Id. at 57.

B. CRS Fees Are Not Excessive.

The sole basis cited in the NPRM for characterizing CRS fees as “high” or “excessive” is a 1991 study — now more than 10 years out of date — that asserted that booking fees charged to airlines “may” have exceeded the systems’ costs of serving airlines “by a significant amount.” 67 Fed. Reg. at 69370, 69382. Apart from the fact that such stale data cannot support current rulemaking decisions, the NPRM makes clear that the 1991 study is based on a flawed methodology. The NPRM notes that it is “almost impossible” to allocate system costs to different categories of users in order to determine whether and how much the CRS fees a user pays may exceed the relevant costs. And the Department states unequivocally that it has “made no finding that each system’s booking fees exceed the system’s costs of providing services to the airlines.” 67 Fed. Reg. at 69400. There is accordingly no basis in the record to conclude that Galileo’s fees are unreasonable or excessive as compared to its costs.²⁷

²⁷ The Department is correct to reject the calls from some quarters to impose a government-mandated “reasonable” fee, under ratemaking procedures, or to impose a cap of some kind on CRS booking fees for carriers. Such regulations are not only completely unnecessary, they would be impossible to administer. Beyond the excessive burdens and costs entailed in ratemaking proceedings, the process would be capricious at best: There is simply no way to allocate costs among various services and various users as the basis for a so-called “reasonable” booking fee. Ratemaking procedures may also destroy incentives to keep costs down. See 67 Fed. Reg. at 69399-400.

In fact, booking fees are a good bargain for airlines. The NPRM recognizes that a CRS provides an extremely efficient and cost-effective means of distribution for the airlines. It states unequivocally that CRSs “have provided tremendous benefits for airlines, travel agents and consumers due to their efficiency.” 67 Fed. Reg. at 69369. CRSs make an airline’s offerings, including new routes, new fares, and promotions, instantly available to travel agents everywhere for immediate sale and booking. This facilitates entry into new markets, and gives airlines tremendous freedom and flexibility to operate their businesses and modify their offerings. Such benefits would not exist without CRS services.

Moreover, rather than simply pocketing booking fees, CRSs have used their revenues to invest in additional airline functionality. For example, in response to carrier demand in recent years, Galileo and other CRSs have developed and implemented e-ticketing. Galileo responded to airlines’ introduction of more and more private fares worldwide by developing PrivateFares II, a secure means for airlines to distribute their private fares to select travel agencies and corporations. Galileo did not charge individual airlines for adding these new services. Rather, it funded these improvements through general booking fee revenues.²⁸

CRS fees are modest, particularly in view of the sophisticated services the systems provide, the vast sums invested to create and maintain the networks, and the value the systems deliver to the airlines. Galileo’s fee for a simple booking at a

²⁸ See EI Analysis, pp. 35-36, for a more extensive discussion of new functionality Galileo has added.

premium level of service, with ticketing, is less than \$3.25 per segment.²⁹ By any measure, this is a very modest charge for the sale of air transportation that may generate hundreds or thousands of dollars in revenues for airlines. Particularly in view of the direct sales costs the airlines save when bookings are made through a CRS (costs of reservations agents, sales offices, etc.), it is clear that airlines get their money's worth and more in exchange for the booking fees they pay.

The NPRM notes that the total booking fee costs of large network airlines were only about two percent of the airline revenues generated by sales through CRSs. See 67 Fed. Reg. at 69370. Galileo's fees remain in this range. This is similar to the amount the airline pays in credit card processing fees when a passenger pays for a ticket with a credit card. CRS booking fees also constitute a very small percentage of total airline expenses – between 1.6 percent and 2.3 percent, depending on the airline.

CRS fees are also not out of line with the processing fees charged for much simpler transactions in other industries. Telecharge and Ticketmaster charges are in the range of \$8 to \$9 per transaction.³⁰ Thus, for a \$40 ticket, the purchaser could pay processing fees of close to 25 percent of the face value of the ticket. Charges for withdrawal of cash from an automated teller machine can be as high as

²⁹ See page 54 note 58, *infra*.

³⁰ See Jack Zink, "Reviews of New Shows On and Off Broadway," Sun-Sentinel, March 10, 2002, p. 4D (Telecharge imposes \$6 service charge per ticket, plus a \$2.50 handling fee per order; Ticketmaster imposes a \$6 service charge per ticket, plus a \$3 handling fee per order).

\$3 per transaction.³¹ Thus, for a \$20 withdrawal the customer could pay a fee amounting to 15 percent of the amount received. The two percent of revenue paid by airlines for far more complex CRS booking services is plainly a bargain.

Some airlines argue that their CRS fees have increased exponentially since the early 1980s. As Economists Incorporated explains, this is highly misleading. In those early years a number of these airlines were the beneficiaries of a highly discriminatory pricing regime.³² Moreover, system owners were able to charge artificially low fees in that period because they earned hundreds of millions of dollars in “incremental revenues” resulting from display and other forms of bias. EI Analysis, p. 46.³³ Since one goal of regulation was to eliminate bias (and thus incremental revenues), it is reasonable to expect that CRSs would find it necessary to increase fees after the regulations went into effect to make up for the lost revenue. See id. at 48.

³¹ See Melissa Allison, “ATM Fees Earn Chicago 2nd City Label,” Chicago Tribune (Chicago Sports Final Edition), Aug. 4, 2000, p. 1 (median ATM charge in the Chicago area and Washington, D.C. is \$3; median charge nationally is \$2.25).

³² See EI Analysis, p. 60 (noting that, prior to regulation, booking fees charged by Sabre and Apollo ranged from \$0.30 per segment for airlines that did not compete extensively with the vendor to more than three dollars for low-fare competitors).

³³ Sabre’s financial records indicate the extent to which incremental revenues affected the performance of CRSs. In 1983, the last full year before regulation began, Sabre reported total cash revenues of \$118.3 million and a net cash flow of \$5.5 million. According to American’s documents, in 1983 Sabre also provided an estimated \$350 million in incremental revenues to American. Assuming that 80 percent of the incremental revenues represented pre-tax profit (the assumption used by the CAB, based on internal airline analyses), American would have earned an additional \$280 million in profit on these incremental revenues. See EI Analysis, pp. 46-47.

In the years since 1984, when the CRS rules were first promulgated, Galileo has increased its fees in some years and its fees have remained flat in other years. At the same time, however, Galileo has added many features and enhancements, some of which are optional and carry additional charges, and many airlines have elected to use these additional features. These enhancements make the Apollo system many times more flexible, more powerful and more valuable to the airlines than it was in earlier years. It is entirely reasonable for booking fees to increase to reflect this increased value.³⁴

Moreover, in recent years, Galileo's costs have increased dramatically, and Galileo must increase fees periodically to cover these costs. Even in a down marketplace, Galileo is processing transactions at a record level. The complexity of fare rules, the frequency of fare filings, and the reality of fare wars have created an extremely high level of shopping activity. In 2001, for example, Galileo's peak was 24 shop queries per second. This year the Apollo system is regularly hitting 36 shop queries per second. In January 2003, the Apollo mainframe and faring complex peaked at an all-time high for transactions. This increased activity has added more than 50 percent to shopping and mainframe volumes. Over the past 15 months

³⁴ See EI Analysis, p. 57 ("changes in the level of fees charged [are] reflective of changes in the level of service or the costs associated with the provision of new and enhanced CRS services"); see also id. at 49 (prices for services that make up the highest level of Galileo functionality "have tended to increase only modestly in recent years"). Of course, much of the increase in CRS fees of which carriers now complain was imposed by the airline owners of CRSs in the period when all CRSs were owned by airlines.

Galileo has seen a 50 percent growth in shopping costs, and this trend is expected to continue.

This shopping growth, and related costs due to the need for incremental hardware, are on a steep rise with little end in sight for three major reasons. First, airlines are filing very high numbers of fares (more than three million in January 2003 alone). Second, fare wars have led to increased shopping as consumers seek the best fares. (Galileo expects that its costs due to fare wars in 2003 alone will be approximately \$12 million.) Third, increased use of web sites greatly increases the number of transactions compared with actual bookings. The “look-to-book” ratio of a web site is around 100 to 1, compared with a ratio of approximately 10 to 1 for a traditional travel agency.

As a result of the proliferation of fares and the increasing complexity of fare rules, especially the huge increases in the number of private fares, Galileo has had to make major expansions to its processing capacity. In 2001, Galileo more than doubled its fare processing capacity by adding 24 new fare processors at a cost of many millions of dollars, in order to manage the large airline-driven increase in the number and complexity of fares.

In any event, it is incorrect to focus only on fees charged to airlines. As Economists Incorporated explains, it is necessary to examine revenues and costs of the entire company, including not only CRS services to airlines, but also services

to travel agents (as well as other lines of business). See EI Analysis, p. 46.³⁵ Moreover, the fact is that, while CRS services bring substantial benefits to travel agents and consumers, the primary beneficiaries of these services are the airlines. The Department cites data showing that fees paid by airlines account for about 90 percent of CRS revenues, with travel agents accounting for about 10 percent, and implies that this is evidence that CRSs impose “costly and burdensome requirements” on airlines. 67 Fed. Reg. at 69382, 69398. But this ignores the fact that it is the airlines’ products that are distributed using CRS services; travel agents act only as agents on behalf of the airlines for that purpose. It would be surprising, to say the least, if someone other than airlines paid the lion’s share of costs for airline distribution.

Airline complaints about booking fees are plainly not a sufficient basis for withdrawing the mandatory participation rule and the ban on discriminatory fees. As Economists Incorporated concludes, it is unlikely that removing the rules would induce additional price competition. See EI Analysis, pp. 63-66. They properly find that any benefit from removing the rules would be outweighed by the detriment to airline competition, and particularly to low cost and smaller airlines and to consumers, that would result from such a move. Id. at 2-3.

³⁵ Of course, as the airlines have reduced commission levels, and more recently abolished commissions altogether, travel agents have looked to CRSs for additional financial support, raising CRS costs significantly.

V. THE DEPARTMENT SHOULD DECLARE THAT ORBITZ IS SUBJECT TO THE CRS RULES.

The preamble to the NPRM asks for comment on “how best to exclude Internet sites from the scope of [the] rules.” See 67 Fed. Reg. at 69390. Galileo agrees that most on-line travel sites should not be regulated. However, Orbitz has key characteristics of an airline-owned CRS and should be regulated as such. In addition, as explained below, Orbitz presents the same sort of threat to competition as traditional CRSs presented when the CAB first imposed CRS regulation in 1984. Rather than seeking ways to ensure that Orbitz will fall outside the coverage of the CRS rules, the Department should be taking steps to ensure that the rules are appropriately applied to it.

A. Orbitz Currently Falls Within The Definition Of A CRS.

Based on information available to Galileo, Orbitz meets the definition of a “system” under the current CRS rules.³⁶ Orbitz is airline-owned; in fact, it is owned by the five largest U.S. airlines – American, Continental, Delta, Northwest, and United – representing 72 percent of the market. Like traditional CRSs, Orbitz enters into contracts with airlines, which pay Orbitz for providing information and booking capabilities to users. (There are 42 airlines under contract to Orbitz, representing approximately 90 percent of U.S. airline capacity.) Just like traditional

³⁶ Because Orbitz is now a CRS within the meaning of the rules, the Department should be taking steps to enforce the regulatory requirements with respect to Orbitz and its owners. As described below, most Orbitz owners are withholding web fares from traditional CRSs. This constitutes a violation of 14 C.F.R. § 255.7(b).

CRSs, Orbitz collects information on airline schedules, fares, and availability of seats, and arranges that information under editing and ranking criteria.

Even if Orbitz previously might have argued otherwise, it now fits squarely within the definition of a CRS. Orbitz continues to use Worldspan as the booking engine for some of its transactions. However, beginning in August 2002, it has developed direct connections with various carriers, similar to those maintained by traditional CRSs. To date, direct connections include American, Northwest, and Continental.³⁷ A number of other airlines (including Alaska, America West, Delta, Hawaiian, Midwest Express, National, and United) are reported to have signed agreements with Orbitz for direct connections. This Supplier Link technology, which Orbitz plans to use to connect with additional carriers, has allowed it to replace all intermediary functionality so that users can book tickets directly with the airlines. For bookings made through the direct connections, Orbitz bypasses traditional CRSs entirely; instead, it acts as the CRS itself.³⁸

Moreover, unlike most on-line agencies, whose primary aim is to serve individual consumers through the internet, Orbitz has turned its attention to travel agencies. As of May 2002, Orbitz entered into an agreement with Navigant International, under which travel agents are able to use the latter company's AQUA

³⁷ Galileo understands that an estimated three-fourths of the Orbitz bookings for these carriers are handled through the direct connections. The remainder continue to flow through Worldspan.

³⁸ Adding direct connections is relatively easy to do and not very expensive. Thus, other on-line travel agencies, such as Expedia, could develop this capability, too. With only five to six direct connections, a travel agency could bypass a CRS and obtain direct access to 80 percent of U.S. air passenger transportation volume.

software for direct booking access to the Orbitz search engine and inventory of fares, including web fares of Orbitz owners and charter associates.³⁹ Testing of the AQUA software for this purpose was to be completed this past fall. There can now be no question that Orbitz is offering its airline distribution services to travel agents and that it is therefore the equivalent of a CRS under the current rules.⁴⁰

Travel agents can complete bookings with airlines using Orbitz technology and connectivity. Under the Orbitz Affiliate program, travel agency members receive a commission for bookings that originate from banner and other

³⁹ Navigant Press Release, "Navigant's AQUA Software Products and Orbitz to Offer Web Fares to Travel Agents," May 16, 2002. The press release states:

This product will provide travel agents direct access to Orbitz's Web-based search engine and its inventory of low fare ticket prices from more than 455 airlines. . . .

In addition, AQUAquest will give travel agents the ability to instantly and directly access the Orbitz fare database. When an Orbitz fare is selected, agents will be able to book the reservation without having to transfer to and from multiple Web sites. Once booked, the information about the flight will be stored in the traveler's record, along with any hotel and rental car reservations, incorporating the entire transaction into the traveler's management reporting system.

⁴⁰ Orbitz has also begun serving corporations directly. In September 2002, Orbitz announced the successful launch of Orbitz for Business, a corporate booking and tracking tool. Orbitz reports that corporate interest surpassed its expectations. See Orbitz Press Release, "Orbitz for Business Becomes First Corporate Travel Program Implemented by an Online Travel Agency," Sept. 19, 2002.

placements on their web sites.⁴¹ This practice is similar to the financial incentives a CRS pays to agencies.

Orbitz may argue that its replication of a CRS is not subject to the Department's rules because it has established indirect, rather than direct, relationships with travel agency and corporate subscribers. In fact, the Orbitz arrangement has the same competitive, economic, and technological impact on the travel marketplace as a traditional CRS. Orbitz and its owners should not be permitted to circumvent coverage of the Department's rules simply by setting up arrangements that allow it to serve travel agencies via third-party software. In the preamble to the NPRM, the Department suggests that if Orbitz were to make its services available to travel agencies for use in making airline bookings, it would be considered a CRS subject to all of the rules. See 67 Fed. Reg. at 69374. Orbitz today does make its airline booking services available to travel agencies and thus is subject to the CRS rules. The Department should take steps to enforce the rules against Orbitz and its owners. In particular, it should enforce the mandatory participation rule against the Orbitz owners.⁴²

⁴¹ See http://www.orbitz.com/App/affiliate/prog_details.jsp?cache=1047498266062&requestId=505.

⁴² Unless the Department chooses to enforce the CRS rules against Orbitz and its owners, traditional CRSs could respond by altering their business arrangements to fit the Orbitz loophole. Thus, Galileo and other CRSs could switch to an internet-based model and restructure relationships with travel agents to replicate the Orbitz approach. The result would effectively be a completely deregulated environment -- despite the Department's tentative conclusion that the industry is not ready for such total deregulation.

B. There Are Important Reasons To Regulate Orbitz.

Even apart from the fact that it is the equivalent of a CRS under the current rules, there are important policy and competitive reasons to conclude that Orbitz and its owners should be regulated.

The Orbitz owners – United, American, Delta, Continental, and Northwest – are the five largest U.S. airlines, with 72 percent of the U.S. passenger air transportation market. Given the dominance of each of these carriers in certain cities, even their unilateral conduct with respect to distribution of air transportation warrants special scrutiny. A combination formed by this group plainly raises the potential for anticompetitive activity.

Of particular note, each of the five Orbitz owners is a current or past owner of a CRS. United formerly owned the Apollo/Galileo system; American formerly owned Sabre and is now a part owner of Worldspan; Delta and Northwest are part owners of Worldspan; and Continental formerly owned SystemOne, now Amadeus.

The Department is well aware of the relevant history. In the early 1980s, following widespread complaints about the manner in which airline-owned CRSs were conducting their operations, the CAB concluded that these airline owners had market power and were exercising it in an anticompetitive manner. The agency identified various CRS practices that appeared to harm competition and consumer welfare, including screen bias, discriminatory booking fees, certain subscriber contract provisions, and use of marketing information to obtain competitive advantage in the airline business, and it promulgated rules limiting such practices.

Over the years, the Department has concluded that CRS regulation should remain in place, due to the continuing threat to airline competition posed by airline-owned CRSs.

The Orbitz owners are the same airlines that the CAB and the Department found to be engaging individually in competitive abuses in connection with their operation of CRSs. The Department certainly should not assume that the same airlines will combine to operate Orbitz in a competitively benign manner.

In fact, the Orbitz owners are clearly acting in an anticompetitive manner in their operation of Orbitz. Smaller carriers have little choice about whether to participate in Orbitz. A system sponsored by the five largest U.S. carriers constitutes a marketplace, and most other carriers are not in a position to refrain from participation. Through “charter associate” agreements with dozens of other airlines (the terms of which are essentially dictated by Orbitz), the Orbitz owners encourage these airlines to provide their own attractive web fares to Orbitz (regardless of whether the airline wants those fares distributed beyond its own site), while restricting their availability to other distribution channels, including CRSs. These web fares are the airlines’ “bargain” inventory, and they are highly sought after by travelers. Without access to these fares, traditional CRSs (and travel agencies served by those CRSs) and other services that compete with Orbitz become far less attractive.

Where airlines deny web fares to CRSs, travel agents cannot readily access them. Agents may be able to take extra steps to access web fares through

other channels, but this process is more time-consuming and less efficient.⁴³ As a result, traditional travel agents cannot compete as effectively with other distribution channels.⁴⁴ Consumers who prefer to or must use the professional services of a travel agent are deprived of efficient access to some of the most attractive fares. Individuals who do not use the internet (almost half of the U.S. population, as of September 2001⁴⁵) are also disadvantaged because they cannot obtain these fares.

Galileo has been able to obtain access to web fares of only one Orbitz charter associate (US Airways) and one Orbitz owner (United), in exchange for a substantial discount on all booking fees. Although Galileo is willing to extend similar terms to other carriers, none have signed up for the program.

The fact that two carriers have recently made their web fares available to Galileo does not suggest that the Orbitz web fare strategy is going away. Other carriers have refused to provide access to their web fares, or have conditioned access

⁴³ Moreover, when travel agencies have tried to access web fares using web-based shopping tools such as FareChase and AgentWare (which enable agencies to book web fares with no assessment of booking fees to the airlines), one of the airline owners of Orbitz (American) responded by issuing warnings to these companies. See Dennis Schaal, "American, Orbitz: Site Scrapers Keep Out," TW Crossroads (Sept. 24, 2002). American recently obtained a preliminary injunction against use of FareChase to search American's web site for fares. See Travel Management Daily, Mar. 11, 2003. However, agencies would be able to access these web fares if they were to use Orbitz.

⁴⁴ Even if web fares constitute only a small percentage of an airline's total ticket sales, denial of these fares to distribution channels other than Orbitz is a significant problem. Access to web fares is an important means of attracting business to a CRS or other distribution channel.

⁴⁵ U.S. Dept. of Commerce, National Telecommunications and Information Administration, "A Nation Online: How Americans Are Expanding Their Use of the Internet" (Feb. 2002), at 1. Presumably those who do not use the internet are predominantly lower middle class and poor individuals.

on unreasonable demands. For example, one major airline demanded a 75 percent reduction in all booking fees in exchange for granting Galileo access to web fares. A demand for such drastic cuts in Galileo revenue is nothing more than a stonewall tactic. It demonstrates not only that CRSs lack market power with respect to airlines, but that withholding of fares is a strategic weapon airlines use to disrupt and control the distribution chain, and effectively distort airline competition. Regulation is needed to deter such strategies.

The key mechanism used to confer discriminatory access to attractive web fares on Orbitz is a most favored nation (“MFN”) arrangement that is part of the Orbitz charter associate agreement. By agreeing to the MFN provisions, the Orbitz “charter associates” are forced to coordinate distribution of all of their fares, including discount web fares, and to impose restraints on their individual decision-making about which outlets to use for distribution. The MFN provisions have two components that support this result: First, each airline must make available to Orbitz all published fares that are available through the airline’s own web site; and second, each airline must make available to Orbitz all of the published fares the airline offers to any other third-party distribution channel, provided Orbitz matches that third party’s terms.⁴⁶ All airlines that wish to participate in Orbitz (and few can afford not to, given Orbitz’s rapid rise to prominence) are required, as a condition for participation, to agree to these restraints on their individual decision-making for a three-year period.

⁴⁶ U.S. Dep’t of Transportation, Office of Aviation & International Affairs, Report on Efforts to Monitor Orbitz (2002), at 7, 14-15.

The MFN restraints may appear to be non-exclusive and theoretically allow airlines to provide discounted web fares to CRSs and other third parties. These restraints cannot be evaluated in the abstract, however, but must be examined in the context of the practical realities of the marketplace. In actual operation, the MFN provisions have given the Orbitz collaboration exclusive access to discounted web fares of most major airlines. Several real-world factors combine with the MFN provisions to bring this about.

First, airlines assert that the lowest-cost distribution channel is their own web sites and internal reservation systems.⁴⁷ As web fares have become a more established form of discount fare, airlines are increasingly willing to offer them through other channels, but invariably want to continue to offer them through their own web sites — which are the source of more than half of all online sales.⁴⁸ That triggers the MFN obligation to make the fares available to Orbitz: Even if another online travel site or CRS offers terms that Orbitz is unwilling to match, Orbitz still gets the fare because it is available on the airline's own web site. The MFN provisions effectively ensure that Orbitz gets all web fares.

Airlines also wish to limit the visibility and availability of discounted web fares for a number of reasons.⁴⁹ For strategic reasons, an airline might prefer not to offer some web fares through Orbitz, but to negotiate with one or more other outlets instead. Unless it is prepared to forgo sales of the web fare through its own

⁴⁷ See id. at 23-24.

⁴⁸ Id. at 8, 15.

⁴⁹ Id. at 15-16, 21, 23.

web site, however, it must offer the web fare through Orbitz. If it wants to preserve a strategy of limited availability, therefore, the airline cannot offer the web fare to third parties, even at favorable terms.

Moreover, the five Orbitz airline owners, with 72 percent of the U.S. market, have substantial financial incentives to support Orbitz at the expense of all other outlets, and to reserve their web fares to Orbitz. The MFN provisions allow the Orbitz owners to impose the same restraints on participating airlines, which must agree to the MFN provisions in order to participate in Orbitz at all. The result of the Orbitz ownership structure and MFN provisions is plain: the consolidation of virtually all web fares in a single outlet controlled by the five major U.S. airlines with 72 percent of the market, and the exclusion of other third-party outlets from access to most of those fares.⁵⁰

The experience of another Cendant affiliate, Trip Network, presents a particularly stark example of the effects of the Orbitz restrictions. Trip Network operates Cheaptickets.com, an online travel agency. Cheap Tickets and its founders pioneered the distribution of discounted airline tickets; it depends heavily on fare incentive agreements with over 40 airlines.

⁵⁰ In a letter to Senator John McCain dated January 7, 2003, the American Antitrust Institute predicted that practices of the Orbitz owners, combined with the elimination of the mandatory participation rule, will undermine CRS competition and will tend to force agents to switch to the Orbitz/Worldspan system. As AAI noted, if carriers “are permitted to vertically integrate into ticket sales in a way that gives them market power at the distribution level, consumers will have fewer choices, less objective information, and ultimately, higher fares.” See www.antitrustinstitute.org/recent2/225.cfm.

In June 2001, as Orbitz was about to launch, Cheap Tickets received an e-mail and telephone call from a representative of an Orbitz owner advising that this carrier was discontinuing its domestic discounted fare program through Cheaptickets.com and that these fares should be removed immediately. The representative explained that the airline wished to avoid providing the same low fares to Orbitz -- i.e., to have the MFN provision invoked against it. As a result, Internet sales of this Orbitz owner's discounted fares on Cheaptickets.com decreased by 97 percent year over year after Orbitz launched.

Subsequently, not long after the Orbitz launch, an Orbitz charter associate member, which had distributed branded discounted fares on Cheap Tickets' web site, converted to distribution of opaque, or unbranded, fares to avoid triggering Orbitz's MFN clause. This branded-to-opaque switch all but eliminated sales of this airline's discounted fares on Cheaptickets.com; year-over-year online sales are down 95 percent.⁵¹

Cheap Tickets has continued to be successful in obtaining short-term, market-specific arrangements with various airlines, including short-term access to web fares of some Orbitz owners. However, thus far it has been unable to obtain more comprehensive access of the sort Orbitz has through its charter associate

⁵¹ Cheap Tickets reports that opaque fares are typically less attractive to its demographic because the customer doesn't learn the carrier or departure and connection times until the ticket is purchased.

agreements. Thus, it appears that the MFN continues to have a chilling effect on the availability of web fares.⁵²

Professor Hausman has explained that the effect of the Orbitz MFN provision is anticompetitive:

Because of the operation of the MFN, Orbitz participating carriers have a decreased incentive to offer price cuts because they know that other airlines will become immediately aware of the cuts and will respond accordingly. . . .

The improved monitoring of price cuts made possible by the Orbitz MFN clause thus would be expected to result in decreased discounting among carriers, resulting in higher air fares to consumers. . . .

Thus, in airline oligopoly markets, where often two competing airlines exist on a given OD route, the Orbitz MFN clause can be expected to lead to less discounting of prices.

Hausman Study, pp. 6, 7. Professor Hausman tested this hypothesis through econometric analysis of the empirical data. His analysis showed that “the launch of Orbitz has resulted in . . . decreased fare dispersion, which has harmed consumers by making deeply discounted fares less available than before Orbitz began operation.”

Id. at 11. Professor Hausman therefore concludes that “Orbitz has had an anticompetitive effect on airfares and has caused direct injury to consumers.” Id.

The Department apparently has little concern about Orbitz and its effect on competition. As a recent study issued by the Progress & Freedom Foundation notes, however, the Department appears to “underestimate the

⁵² Cheap Tickets is hoping that Galileo’s new pricing for web fare bookings will persuade carriers to grant broader access to web fares. See page 55, infra.

competitive advantage Orbitz currently holds and the potential for it to achieve dominance in the future“ due to the MFN.⁵³ Moreover, as Professor Hausman has confirmed, this anticompetitive conduct by Orbitz is already having a significant adverse impact in the marketplace.

It is critical that the CRS rules not give an unfair advantage to Orbitz. CRS competitors of Orbitz must be able to compete on a level playing field. As discussed above, Orbitz is now operating a CRS in certain respects, and (like airline owners of CRSs) its owners have incentives to use their system to further their airline interests. The Orbitz owners have acted on those incentives by engaging in anticompetitive conduct similar to that of CRS-affiliated airlines. Thus, there is every reason to treat Orbitz as a “system” for purposes of the CRS rules.⁵⁴

C. The Allegation That Orbitz Offers Lower Distribution Costs Does Not Provide A Basis For Declining To Regulate Orbitz.

Orbitz and its owners have suggested that it should not be regulated because it offers a procompetitive alternative to CRSs. They claim that CRS booking fees are too high and that Orbitz offers lower distribution costs. However, the premise of the argument is incorrect. In fact, based on information available to Galileo, Orbitz fees appear to be either equal to or higher than CRS booking fees.

⁵³ William F. Adkinson, Jr., “Orbitz Should Still Pop Up on Antitrust Agencies’ Radar Screens,” Progress on Point, Release No. 10.7 (Mar. 2003), at 3.

⁵⁴ In any event, the Department should not be suggesting, as it appears to in proposed 14 C.F.R. § 255.6(e), that airlines need not offer all fares through all channels. Rather than shielding the strategic behavior of the Orbitz owners to advance their own interests, the Department should be encouraging equal access to fares.

Unless Orbitz has established a direct connection with the airline, it passes on to its airline customers a rebate it has negotiated with Worldspan (which Orbitz uses as its booking engine).⁵⁵ Orbitz has represented to the Department that the total cost to an airline for a hypothetical booking that includes three segments would be approximately \$12.⁵⁶ In the same filing, Orbitz asserted that Galileo fees for the same three-segment trip would also be in the range of \$12 (based on the assumption of a Galileo fee of \$4 per segment).⁵⁷ By Orbitz's own account, it has no cost advantage in this situation.

Galileo recently introduced a new pricing model. Applying this model to a simple premium booking of three segments with ticketing, it appears that Galileo's fee would be lower than that of Orbitz. Galileo estimates that the total Galileo fee for such a transaction would be \$9.69, considerably lower than the \$12 cost that Orbitz reported last year.⁵⁸ For an airline that has signed up for Galileo's

⁵⁵ Where Orbitz has a direct connection with the carrier, a fee of \$4 from Orbitz replaces the Worldspan fee. This is in addition to a transaction fee of \$6.37, for a total of \$10.37.

The airlines' willingness to pay fees to Orbitz is in sharp contrast to their unwillingness to pay commissions to travel agencies. This disparate treatment is just another example of the airlines' provision of preference to their own distribution channels.

⁵⁶ Answer and Motion for Leave to File of Orbitz, L.L.C., Docket No. OST-2002-12004, filed June 18, 2002, at 11.

⁵⁷ *Id.* at 10. In fact, this assumption overstates Galileo's per segment fee in many situations.

⁵⁸ The Galileo fee for a premium booking of a single segment would be \$3.23, computed as follows: \$1.70 (net fee) + .68 (transaction fee) + .25 (Interactive Sell premium) + .10 (Inside Availability premium) + .50 (ticketing fee). For three segments, the fee would be 3 x \$3.23 = \$9.69.

new Momentum program, the cost for booking the same three segments through a participating Galileo agency would be less than \$7.00. See pages 32-33, supra.

Galileo's fee for web fare bookings is also lower relative to the fees charged by Orbitz.⁵⁹ For a simple web booking, more typical of the average book-and-fly reservation on Orbitz, Galileo's per-segment fee would be \$3.50, regardless of whether the booking is changed. For an itinerary of three segments, the total Galileo fee would be \$10.50 (i.e., 3 times \$3.50). Thus, Galileo's fee for a web fare booking presumably is lower than Orbitz's \$12 charge for the same booking. If the airline has established a direct connection, the total fee of \$10.37 the airline pays to Orbitz (see page 54 note 55, supra) would be approximately the same as the Galileo fee. For a web fare with only two segments, Galileo would charge only \$7, considerably less than the Orbitz fee.⁶⁰

This simple comparison of out-of-pocket costs does not take account of all the relevant costs. For example, a direct connection with a customer involves internal processing costs, internal customer acquisition costs (including high cost call centers), and marketing costs. The airlines incur marketing costs for Orbitz that they

⁵⁹ Galileo recently began rolling out the special web fare pricing described in the text.

⁶⁰ The only way Orbitz can claim to provide lower cost distribution than Galileo (and presumably other CRSs) is to inflate the cost of the CRS booking by adding an amount for an override commission. This is a payment the air carrier may choose to make to the travel agent – not the CRS – in exchange for directing a high share of business to that carrier. This is a voluntary payment by the air carrier, used as a marketing tool in order to gain more business. It is inappropriate to place a thumb on the scale by adding an override commission to the CRS fee when comparing CRS fees with Orbitz fees.

do not experience with any other channel. The Orbitz “charter agreements” obligate the “charter associates” to provide a minimum of \$14 million of in-kind marketing per year for Orbitz. This could include references to Orbitz in printed promotional materials and in suppliers’ fare sale advertising and free tickets for promotional use. Using the Orbitz Form S-1 filed with the SEC on May 20, 2002 as a guide, and allocating these marketing costs attributable to airlines based on the percentage of Orbitz revenue for the three months ending March 31, 2002, on a per ticket basis, the airlines incur \$1.93 for distribution through both Orbitz direct and Orbitz with Worldspan channels.⁶¹

In addition, Orbitz owner airlines currently incur both the cost of capital and the risk of non-recovery of principal on the investments that they have made in Orbitz, costs they do not face in their use of non-Orbitz distribution channels. According to the Orbitz Form S-1, the Orbitz founders have invested approximately \$205 million in Orbitz through the period ending March 31, 2002.⁶² Of this amount, some \$39 million remained on the Orbitz balance sheet in the form of cash and cash

⁶¹ These sizeable expenditures have contributed to the economic woes of Orbitz owners and come at a time when the owners are seeking a billion dollar bailout from American taxpayers.

Based on fully allocated costs, it appears the CRS channel is a lower cost alternative compared to Orbitz. Perhaps in these times of industry crisis the Orbitz owners should consider investments other than this supposedly “low cost” distribution channel. *See* Orbitz, Inc., Form S-1 (filed May 20, 2002), at 9 (noting that Orbitz has “a history of operating losses” and “expect[s] to incur losses in the future”); *id.* (depending on various contingencies, “we may not achieve or sustain profitability”).

⁶² *See* Orbitz Form S-1, Combined Statements of Cash Flows for Orbitz, Inc. and Orbitz, LLC, p. F-6.

equivalents on March 31, 2002. Thus, as of that date, the founders' net reported investment outlay in Orbitz was \$166 million.

Assuming that no part of this investment has been recovered since then, at least \$24.9 million in Orbitz imputed cost of capital (assuming a weighted average cost of capital of 15 percent) presumably can be ascribed to the founding airlines as an additional cost of Orbitz distribution for the 12 months ending March 31, 2003. This would translate into an additional cost of approximately \$5.36 per ticket sold through Orbitz for the founding airlines.⁶³

Moreover, the comparison of out-of-pocket costs also does not take account of another significant factor – the impact on an airline's yield of booking through Orbitz versus booking through a CRS channel. Bookings made through a traditional travel agency result in a relatively high yield for an airline. Galileo believes that bookings made through Orbitz result in a relatively low yield. When relative yields to the airlines are considered, it becomes clear that Orbitz cannot be regarded as a lower cost distribution channel. Not only are the direct costs to airlines of Orbitz bookings higher in many cases, the airlines forgo yields as well when more bookings are made through Orbitz.⁶⁴

⁶³ If the recovery of the founders' investment is not completed by the end of March 2003, additional imputed cost of capital should be ascribed to the Orbitz channel in 2003 and beyond. Cost of capital would continue to be imputed until the Orbitz founders recovered their original investment plus the total amount of interest forgone since they made their original investment. Obviously, any future write-down of the founders' investment in Orbitz would increase the cost of this distribution channel beyond what is shown here.

⁶⁴ Overall information on airline yields tends to confirm this picture. Based on a review of the Form 10-Qs that airline owners of Orbitz filed with the SEC for 2001,

From an overall perspective, then, it appears that Orbitz is not saving money for its airline participants, and indeed may be adding to their losses. Thus, Orbitz may actually be contributing to the need for federal bailouts of the airline industry, because carriers, in a misguided effort to steer distribution to their own channels, are driving down their yields by pushing distribution through Orbitz, while failing to realize lower distribution costs.

In any event, the claim that Orbitz provides financial benefits to airlines appears to be hollow. Instead, the primary purpose of this collaboration among competitors appears to be anticompetitive, i.e., to make other distribution channels less attractive and distort airline competition.⁶⁵ In this respect, the conduct of the Orbitz carriers is analogous to that of CRS owners in the days before the mandatory participation rule, when these owners limited participation in other systems in order to provide an unfair advantage to their own systems.

The Orbitz carriers' practice of providing Orbitz with access to web fares, while denying such access to CRSs, raises the very same sorts of concerns about strategic behavior to distort distribution and airline competition that led the Department to conclude in 1992 that a mandatory participation rule was needed to

revenue yield per passenger mile for the major U.S. carriers has declined sharply since the beginning of 2001. The largest declines in yield came not in the post-September 11 period, but in the second and third quarters of 2001 -- the period when Orbitz started up and increased its volume of transactions sharply.

⁶⁵ The fact that carriers are declining to provide web fares to Galileo, when the cost to the carrier is equal to or less than the cost of booking such fares through Orbitz, raises significant questions about the carriers' motives. The strategy pursued by the carriers appears to be based not on business considerations but on a desire to shut out other distribution channels.

protect competition. The public interest requires that Orbitz owners be subject to the mandatory participation rule, as well as to other CRS regulation.

VI. GALILEO SUPPORTS CONTINUATION OF THE DISPLAY REQUIREMENTS.

Prohibitions on bias in screen displays have always been at the heart of the CRS rules, and the Department proposes to continue these prohibitions. Galileo supports continuation of existing display restrictions. All CRSs have adjusted their displays to the Department's requirements. Thus, it makes sense to retain the display rules for now.⁶⁶

Once all CRSs (including Orbitz) no longer have an ownership, marketing, or other affiliation with an airline, there should be no reason to retain display rules. The Department has noted that competition among CRSs for travel agency subscribers is fierce. As a result, a CRS must provide useful displays in order to retain subscribers. In turn, consumers can choose among travel agencies, and agencies therefore must provide a high level of service in order to retain their customers. Thus, it is unlikely that a CRS without any airline affiliation would choose displays that do not meet consumer needs.⁶⁷

⁶⁶ On the other hand, if the Department decided to dismantle other portions of the CRS rules, particularly the mandatory participation rule and the prohibition on discriminatory booking fees, there would be little basis for retaining the display rules. A decision to lift restrictions on airline owners' ability to withhold participation and content from other CRSs would suggest the Department was no longer concerned about airlines' strategic use of CRSs.

⁶⁷ Hotel and car displays have remained unbiased, due to these marketplace pressures.

Moreover, the reality is that CRSs no longer provide the only agency displays. Many leading travel agencies use software that allows them to access different sources of information (including different CRSs) from the same terminal. Software from companies such as TRX, Carlson, and Outtask have or will become viable substitutes for CRS displays. These products effectively integrate within an agency display non-CRS air content such as web fares and direct connections to airlines and other vendors.

Of course, eliminating the display rules does not mean CRSs will be free to do whatever they wish with respect to displays. If any CRS should present a display that is deceptive, the Department or another agency can use its enforcement powers to address the situation.

The Department should clarify one proposed change that relates to travel agency displays. The Department has proposed to prohibit any system or carrier from making available to subscribers “any computer hardware or software that reorders an integrated system display on the basis of carrier identity.” This provision (proposed 14 C.F.R. § 255.11(b)) is a response to American’s distribution to some Sabre agencies of a program that enabled them to bias their displays in favor of American. See 67 Fed. Reg. at 69397. It is unclear from the language of the proposal

Since the Department finds it unnecessary to regulate the ordering of flights in screen displays for on-line travel services, which consumers access directly, there should be little basis for concern about CRS displays for travel agents, who are less likely to be deceived by displays than individual users. Hotel and rental car displays have long been unregulated, but there is no evidence of any adverse impact on these businesses.

whether the Department intends to cover more than the sort of software American distributed.

The Department should make clear that any such prohibition would not bar a CRS from providing travel agencies with software that permits the agency to create a profile based on a customer's preferences. Galileo's Travel Screen feature permits an agent to program a profile containing the preferences of an individual customers or corporations. In some cases, this profile may include a carrier preference. However, the agent is free to create preferences for any carrier. Galileo does not in any way pre-program the software to favor a particular carrier.

Galileo provides such software because travel agencies want it and believe it will increase their productivity. The Travel Screen feature has been part of the Apollo system for many years. Indeed, Galileo's predecessor brought it to the Department's attention in 1991, and the Department indicated its awareness of the feature when it decided not to bar travel agencies from creating biased displays. See 57 Fed. Reg. at 43809 (citing Covia Comments, Powers affidavit, para. 25).

Travel Screen remains a neutral tool, as it was in 1991, when we first called this feature to the Department's attention. So long as there is no prohibition on travel agents themselves altering CRS displays, there is no basis on which to prohibit Galileo from providing them with this capability. The Department should clarify this point to avoid confusion.

VII. THE DEPARTMENT SHOULD NOT CHANGE THE RULES GOVERNING SUBSCRIBER CONTRACT TERMS.

In proposing to remove the mandatory participation provision and the ban on discriminatory pricing (when there is still a strong need for limits to deter abuse), the Department purports to be deregulating the CRS business. But when it comes to subscriber contracts (where CRSs admittedly face a fiercely competitive situation), the Department goes in just the opposite direction. Rather than permitting CRSs and travel agents to negotiate whatever mutually agreeable business arrangement meets their needs, the Department seeks to micromanage contract terms.

In particular, the Department proposes to prohibit pricing discounts, incentives, or liquidated damages that are based on the subscriber's volume or use of the system. The Department believes these changes may remove barriers to the ability of travel agent subscribers to switch from one system to another, or to use multiple systems. 67 Fed. Reg. at 69405-08. However, that premise is faulty: Travel agents today have no difficulty switching systems, or making use of multiple systems when it makes business sense to do so.

A. Travel Agencies Are Not Precluded From Switching Systems Or Using Multiple Systems.

Travel agencies do not face any practical restraint on their ability to switch CRSs as a result of subscriber contract terms. As the NPRM itself recognizes, CRS systems "compete vigorously for travel agency subscribers." *Id.* at 69405. It is travel agents, not CRSs, that have the leverage in the relationship. Travel agencies do not hesitate to switch CRSs, or use the threat of switching to renegotiate their contracts and extract additional benefits from the CRS vendor.

Galileo can confirm from its own experience that there is fierce competition among CRS vendors to woo subscribers of other systems to switch, and to offer substantial inducements to persuade their own subscribers not to switch. Agencies do in fact switch systems; this is by no means an unusual event. In the last 12 months alone, Galileo has lost accounts totaling approximately one million segments annually. In the same period, Galileo gained accounts totaling approximately five million segments annually. Thus, when agents wish to switch CRS vendors, they plainly have the ability to do so.

Obviously Galileo is often successful at keeping many of its subscribers. But the fact that an agency does not switch systems does not mean there is no competition, or that agencies face any meaningful barriers to switching. In the fight to retain subscribers, systems commonly are forced to grant substantial financial incentives to many travel agencies, including not only free use of equipment but also up-front payments and payments during the contract term.

Based on their review of the empirical evidence, Economists Incorporated concludes that productivity pricing does not have any significant effect on an agency's decision to switch systems.

[T]he ability and ease of switching is depend[en]t on factors other than productivity payments. The larger agencies can and do switch even with the payments, and the smaller agencies are unlikely to switch even if there were no productivity payments. The existence of productivity payments thus may have little effect on subscribers' ability or willingness to switch to an alternative CRS.

In addition, agencies that wish to do so are not prevented from using more than one CRS. Here, advancing technology presents a far different picture from the one the Department perceives. A number of larger travel agencies such as Carlson Wagonlit Travel have begun to use desktop software functionality that is “CRS agnostic.” Such software allows use of multiple CRSs from a single desktop and even makes it easy for the same travel counselor to access multiple CRSs.

CRSs do not stand in the way of travel agents that wish to use such “CRS agnostic” software. In fact, Galileo partners with Innosys, one of the vendors of such software. With this product, a travel counselor can access Apollo, as well as other CRSs, from a computing platform other than the Galileo platform. At present, 32 Apollo subscribers are using the Innosys software. (In addition, 15 Galileo subscribers in other countries use this software.)

The primary reason more agencies do not regularly use more than one CRS is not because of any barriers imposed upon them, but because they do not perceive any significant benefit to them or their customers from doing so. Galileo’s Apollo service provides comprehensive schedule and fare information, and efficient and user-friendly means to complete virtually any transaction its subscribers desire (except for transactions involving carriers that have chosen not to participate in Apollo). Thus, there is little reason for an agency to use two or more CRSs at the same time.

Moreover, as the Department acknowledges (see, e.g., 67 Fed. Reg. at 69379), there are inefficiencies that result from using multiple systems -- e.g., added training cost and the inability to coordinate bookings from different sources with a

single back-office system. Agencies, which operate with razor-thin margins, are not in a position to incur these extra costs. Changes in the rules for subscriber contracts will not cause travel agencies to use multiple systems if they do not see any benefit from doing so now.⁶⁸

On the basis of their review of empirical evidence, Economists Incorporated agrees that subscriber contract terms are not the basis for travel agents' decisions not to use multiple CRSs.

[T]here are fixed costs associated with the installation and use of a CRS by a travel agent. To utilize multiple systems, a travel agent may need multiple private telecommunications networks and multiple ticket printers. It would also have to integrate the data generated by each CRS into a single back-office system and deal with the extra training and inefficiencies of using two different systems. There are good business reasons why a travel agency, even in the absence of productivity payments, would find it costly and inefficient to utilize multiple systems. We do not believe that it would promote competition to ban productivity payments (which are a form of competition) on the basis that it might promote the use of multiple systems by travel agents.

EI Analysis, pp. 78-79.

The Department's belief that subscriber contract terms may restrain agencies from making use of the internet as an alternative channel of fare information is likewise unfounded. See EI Analysis, p. 4 ("Productivity payments do not appear to decrease travel agents' use of the Internet or other alternatives to CRSs.").

Agencies may freely use the internet to seek out information about fares. For

⁶⁸ See Letter from John W. Lewis, Travel Management Partners, March 13, 2003, submitted in this docket.

example, airlines like USAirways and Northwest Airlines have established web portals specifically for travel agents.⁶⁹ These and other airlines promote web portals as giving agents access to promotional discount web fares.

In addition, new technologies are now broadly available that make it easy for travel agents to shift seamlessly between CRS and internet-based information. One example is the AQUA software product, developed by travel agent Navigant International and now offered to other travel agencies, which allows travel agents to access Orbitz's search functions and book Orbitz fares directly from their CRS displays.⁷⁰ When the travel agent makes an Orbitz booking with the AQUA software, the information is automatically transferred into a passive segment in the CRS, which allows the agent to create a complete passenger name record for the booking.

Galileo itself provides substantial support to help its travel agent subscribers gain easy access to internet-based fares. The Galileo WebFares Shopping Tool, for example, allows subscribers to search multiple internet sites with a single search. Subscribers can use these tools to access the WebPoint feature that Galileo has developed together with AgentWare, a leader in web fare search technology.⁷¹ In fact, Galileo has integrated the Agent Ware WebPoint web search engine into the

⁶⁹ See www.travelagent.usairways.com and www.worldagentdirect.com.

⁷⁰ See <http://www.navigant.com/travelNews/pressReleases/OrbitzAQUA051602>.

⁷¹ More information about the WebFares Shopping Tool, AgentWare and WebPoint is available at <http://www.galileo.com/agencies/ap/ss/apsssalr.htm> or <http://www.agentware.net/>.

Galileo desktop so that travel counselors can work in their preferred environment, make their normal entries, and have Galileo pass on the needed information to the web search engine. This Galileo solution provides the travel counselor with access to web fares from up to 30 web sites simultaneously and facilitates documentation of the web fare search and building of a passive PNR (if a booking is made), permitting integration of all information into the same back office system.

More broadly, Galileo provides subscribers and third party software vendors the tools necessary to interoperate seamlessly with the Apollo CRS. Galileo makes its application programming interfaces (“APIs”) freely available so that users or third-party vendors may custom-design their own applications to integrate with the Apollo CRS.⁷² Galileo’s XML Select product allows third-party developers to easily integrate their web sites with access to Galileo and the information contained in the Apollo system. Third parties can use this technology to develop applications that make it easier to access internet information from the Galileo desktop.

In short, travel agencies today are free to use the internet channel as a source of information and bookings alongside CRSs.⁷³ They are likely to make use of this channel only if there is a benefit that outweighs the resulting inefficiencies.

Subscriber contract terms are not a material factor in that calculation.

⁷² Galileo’s Application Interface Solutions are described in more detail at <http://www.galileo.com/agencies/ap/sc/apscappi.htm>.

⁷³ Indeed, as described above, it is the airlines themselves that have attempted to block agency use of the internet channel. CRSs have worked with companies such as AgentWare and FareChase to develop integrated solutions for travel agencies that wish to book through the internet. Airlines have responded by suing or threatening to sue these companies. See page 47 note 43, *supra*.

B. Productivity Pricing Arrangements Should Not Be Restricted.

In a fiercely competitive marketplace, Galileo, like other CRSs, must offer substantial financial incentives to win and to keep travel agency subscribers. Many of Galileo's contracts with subscribers include provisions that give subscribers financial incentives based on their volume of transactions. In the last CRS rulemaking, the Department recognized that such "productivity pricing" clauses encourage agency subscribers to make more efficient use of CRS equipment and services. 67 Fed. Reg. at 69408. Now, however, the Department proposes to add a new part (c) to Section 255.7 [currently Section 255.8] that would apparently prohibit payments or discounts based on the volume of transactions generated by the subscriber.⁷⁴

The Department is concerned that, despite the acknowledged efficiency gains of "rewarding travel agencies that make greater use of the equipment provided by a system," productivity pricing may unreasonably restrict travel agency switching or multiple system use, and may deter travel agents from using the internet for bookings. Id. at 69408. The Department also notes that vendors use productivity pricing even when travel agents use third-party equipment. Id.

There is no basis for prohibiting use of productivity pricing. Financial incentives based on volume are an ordinary and common feature of business

⁷⁴ The language of the proposed rule refers only to incentives based on "a minimum share of the subscriber's total transactions." 67 Fed. Reg. at 69427. However, the Department's discussion of the proposal refers more broadly to productivity pricing and other types of volume-based incentives, apparently without limitation to share-based formulas. See 67 Fed. Reg. at 69408-09.

transactions. It is entirely reasonable for a vendor to reward customers that produce more revenue for it, whether or not the vendor's equipment is being used to generate the revenue. In principle, productivity payments are no different from other types of incentive payments, such as the airline's own frequent flyer miles. Moreover, as the Department has noted, in situations where the agent is using the vendor's equipment, productivity provisions help to ensure that travel agents are using equipment efficiently.

As Economists Incorporated explains, an offer of a productivity arrangement is one dimension of competition among CRS vendors. Because competition for travel agent subscribers is fierce, CRSs must compete by offering financial incentives, including productivity payments. See EI Analysis, p. 4 (“Review of productivity payments practices show that productivity payments are, on balance, pro-competitive and provide an important means by which CRSs – particularly non-airline owned CRSs – can expand market share”); id. at 84 (“The fact that these payments have increased so rapidly is evidence of the strong competition among CRSs to place their systems with travel agents.”).⁷⁵

In addition, as Economists Incorporated confirms, travel agencies that prefer not to have financial incentives tied to volume commitments have been able to negotiate contracts that do not include such provisions. See id. at 82-84. Particularly in the post-September 11 period, smaller travel agencies became very concerned

⁷⁵ Economists Incorporated also notes that “there is no supporting evidence for certain airlines’ allegations that productivity payments have adversely affected the level of booking fees.” EI Analysis, p. 4; id. at 84-85.

about their ability to meet volume benchmarks. In response, Galileo introduced its Select and Connect pricing for smaller agencies.⁷⁶ Under this program, smaller agencies may choose attractive pricing arrangements that do not include volume-based commitments. Thus, market practices are evolving naturally to give travel agencies a range of options, and productivity pricing is becoming less prevalent. In these circumstances, there is no need for the Department to impose artificial restraints.

In sum, a ban on productivity pricing will have no positive effect; it will not advance the Department's goal of encouraging multiple system use or use of the internet. Instead, the primary impact will be to discourage entirely normal commercial practices that have resulted from the working of a competitive marketplace.

Banning productivity pricing may actually have the unintended effect of making it more difficult for agencies to switch systems. CRSs will find it difficult to offer generous financial incentives for switching if they do not have some mechanism to provide at least minimal assurance that investment in financial assistance to an agency is likely to pay off and return revenue over time. The inability to offer financial incentives to switch systems may diminish competition. In markets where a CRS-affiliated airline's hub operations give it a dominant position, it may be more difficult for other CRSs to dislodge the carrier's CRS, and more

⁷⁶ Galileo also waived most shortfall fees that agencies would have incurred based on productivity formulas due to their loss of business in the post-September 11 period.

difficult for travel agencies to find an alternative CRS provider. In addition, innovation in the CRS business may diminish if CRSs cannot count on a solid return from their investments in improving their systems.

There is no reason to deprive CRSs of the ability to negotiate financial terms with subscribers that take account of the economic value from use of the system. Some travel agencies want productivity pricing terms, and the parties have agreed to them as one integral part of an overall deal, because of the benefits they provide. A regulatory agency has a heavy burden to show why ordinary commercial terms like these should be prohibited and why the expectations of contracting parties should be set aside. The Department has not identified any reason that would justify banning these commonplace terms and preventing travel agents and CRSs from making the commercial arrangements they prefer.

C. The Proposal Regarding Liquidated Damages Should Be Dropped.

The Department proposes a new prohibition on liquidated damages clauses specifying damages for breach “based upon any estimate or expectation” that the subscriber would have used the system for “any specified number of bookings” during the contract term. The Department explains that it is concerned that such damages provisions may deter an agency’s use of multiple systems. 67 Fed. Reg. at 69427.

There is no basis for such a change to the rules. Liquidated damages clauses based on lost profits or opportunity costs are a common and useful feature of commercial contracts. Such clauses provide certainty about the extent of damages, to the benefit of both parties, and they provide assurance that, if the business

expectations that were fundamental to the deal do not materialize as a result of a party's breach, the other party will be made whole. Moreover, in the competitive environment of CRS subscriber contracts, liquidated damages clauses are part of a total agreement with many inter-related business terms that are negotiated between the parties. There is no reason to limit the options the parties have in their negotiations or to upset the settled expectations of the parties about the contract they have signed.⁷⁷

In view of the financial incentives CRSs provide to travel agencies and other capital costs of establishing service at an agency, as well as its lost revenues, a CRS is entitled to seek compensation for premature termination of a contract. Liquidated damage clauses serve a valuable role, and courts routinely enforce them for that reason: They give both parties certainty, and they help avoid protracted litigation to determine damages.

Finally, liquidated damages provisions promote switching, since a rival CRS can easily determine the cost of buying out a contract. In the absence of liquidated damages, the transaction costs of switching would be much higher, and there would be more litigation on the issue of what damages are due.

⁷⁷ Moreover, liquidated damages clauses can, by definition, have no impact on an agency's decision whether and how much to use a second CRS, or to use the internet in addition to its primary CRS. Damages clauses come into play only upon breach of the contract; at that point, the agency has likely already switched to another CRS provider (which has likely agreed to pay any liquidated damages or otherwise buy out the original contract). During the contract term, the damages provision is irrelevant, and the prospect of liquidated damages upon some breach in the future, whether measured by expected volumes or otherwise, will not affect an agency's choices about multiple system use. The proposed rule will likewise do nothing to encourage agencies to use multiple systems or other sources.

Courts can be relied upon to police unreasonable liquidated damages. If a liquidated damages clause does not result in a reasonable approximation of the likely harm from a contract breach, a court will refuse to enforce it on grounds that it is a penalty.⁷⁸ There is no reason for the Department to regulate liquidated damages provisions.

D. There Is No Need To Further Regulate The Length Of Subscriber Contracts.

The rule governing subscriber contracts currently imposes a maximum contract term of five years, together with an obligation to offer a three-year contract as an alternative. The Department does not propose a change to this rule. However, it requests comments on suggestions from some quarters that the maximum contract term be shortened to three years, or that subscribers be given the unilateral right to terminate the contract without penalty after one year. The Department's concern again is that current contract terms may unreasonably restrain travel agencies from switching; it also suggests that a five-year term may be too long given rapid technology changes.

The lengths of subscriber contracts under the current rules have not impeded travel agencies from switching to other CRSs or from renegotiating a contract under threat of switching to extract better terms from the agency's current CRS. The Department recognizes that "systems already compete for travel agency customers." 67 Fed. Reg. at 69407. It also recognizes the other significant benefits

⁷⁸ Of course, this does not mean no damages are due, merely that further proceedings are necessary to determine what they are.

of longer-term contracts: They reduce the parties' transaction costs; and they permit CRSs to grant much more substantial financial incentives to the travel agency than they could for a shorter contract term. Id.

The Department questions whether shorter subscriber contracts might somehow make airline booking fees lower. In fact, shorter contract terms would only create greater business uncertainty, which will increase the cost of doing business for CRSs.

VIII. THE CURRENT RULE CONCERNING MARKETING DATA IS PROCOMPETITIVE AND SHOULD NOT BE MODIFIED.

In addition to providing reservation services, CRSs for many years have offered MIDT (Marketing Information Data Tapes), pursuant to rules the Department promulgated. See 14 C.F.R. § 255.10. MIDT purchasers use this booking data to operate their business more efficiently. Larger airlines were initially the primary customers for MIDT, but years ago the CRSs developed products to assist smaller carriers. CRSs recently unveiled products for subscribers as well.⁷⁹

The marketing data is primarily used in two ways. First, carriers use it to help plan their route structure. For example, if booking trends suggest that a particular city pair is underserved, a carrier can quickly add capacity. Second, carriers use the data to determine whether subscribers have met their booking commitments in order to receive override commissions. In 1992, the Department determined that MIDT was, on balance, a pro-competitive tool. See, e.g., 57 Fed.

⁷⁹ The MIDT products offered to small carriers and subscribers are more limited, and thus less costly, than the data purchased by larger carriers. None of the MIDT products Galileo offers contain identifying information for individual passengers.

Reg. at 43820 (noting the Department's earlier conclusion that "competition usually benefits when competitors have access to more information").

The Department now proposes to restrict distribution of marketing data in significant respects, apparently based on arguments from smaller carriers and some subscribers. The small carriers generally complain that the larger carriers use MIDT in an anticompetitive manner to deter new entry and to restrain competition. For example, if a low cost carrier is successfully penetrating a market, MIDT allegedly helps a large carrier to observe this penetration and to mount a competitive alternative. The small carrier opponents of MIDT argue that this sort of competitive response is unfair.

Some subscribers argue that a carrier's ability to use MIDT to enforce the terms of an override arrangement is also unfair. They apparently believe that the lack of precise booking data will enhance their chances of collecting override commissions.

Neither of the arguments in opposition to the sale of MIDT is well taken. The one clear phenomenon in today's airline industry is the success of low cost carriers. The availability of MIDT has obviously not restrained competition from these carriers. Furthermore, if a small carrier has proof that an airline has engaged in an anticompetitive campaign to drive it out of business, there are more traditional avenues to pursue such a complaint. Placing a stranglehold on the free flow of market information is not an appropriate response to such a situation.

Similarly a subscriber's performance under an arm's length override contract should not be of any concern to the Department. If an airline is able to use

MIDT to determine whether or not a commission is payable to a subscriber pursuant to an override arrangement, the airline should be free to do so without governmental restraint.

The arguments against distribution of marketing data do not provide a basis for any change in the Department's existing policy.⁸⁰ The Department should retain the current rule without modification.

IX. THE DEPARTMENT LACKS JURISDICTION TO REGULATE CRSs THAT HAVE NO AIRLINE AFFILIATION.

At their inception, the CRS rules covered only airline-owned systems; since 1992, the rules have also covered systems marketed by airlines. As described above, the Department in regulating CRSs has been primarily concerned with airlines' strategic use of the systems to further their interests in air transportation markets. Over the years, the Department repeatedly declined requests to regulate systems that were not owned or marketed by airlines. See 49 Fed. Reg. 32540, 32548 (1984); 57 Fed. Reg. at 43794. More recently, the Department has questioned whether decreasing airline ownership of CRSs might provide a basis to reduce or eliminate CRS regulation. See 65 Fed. Reg. 45551 (2000).

Now, however, the Department is proposing to expand the rules to cover systems that have no affiliation with an airline. There is no basis for this proposal, and it should be rejected.⁸¹

⁸⁰ Furthermore, distribution of marketing data provides a significant revenue stream for CRSs. Thus, this business helps CRSs keep booking fee levels down.

⁸¹ Galileo is not arguing that the Department lacks jurisdiction with respect to Galileo and the Apollo system. As noted above, Galileo continues to have a

Under Section 411 of the Federal Aviation Act, 49 U.S.C. § 41712, the Department has authority with respect to practices of “an air carrier, foreign air carrier, or ticket agent.” The Department appears to recognize that it cannot regulate CRSs without an airline affiliation unless it can show that they are “ticket agents” within the meaning of the Federal Aviation Act. Its strained efforts to parse the statutory definition of “ticket agent” in a way that would bring CRSs within this category are unpersuasive.

The Department argues that a CRS “offers for sale . . . air transportation” and is therefore a ticket agent. See 67 Fed. Reg. at 69384-85. But that is simply not the case. Airlines and travel agents offer air transportation for sale, but CRSs provide an entirely different kind of service. CRSs do not offer air transportation for sale to the public either directly or as agents; they merely provide data storage and processing services and a communications link between airlines and their agents.

The Department argues that CRSs are more than a conduit. In a sense, that is true. CRSs have developed sophisticated functionality for the use of airlines and travel agents, so that displays can be tailored for various purposes, communications between airlines and travel agents flow more quickly, and travel agents can obtain more information. But none of this suggests that a CRS is offering air transportation for sale. That is the role of the airlines and their agents.

marketing relationship with United Airlines, and at this time it does not expect to terminate this relationship. Like other industry participants, Galileo has adapted its operations and business relationships to the current regulatory scheme.

In 1985, Judge Posner declared that the CAB (by then the Department) had no regulatory authority over CRSs themselves, as distinct from the airlines that owned them. See United Airlines, Inc. v. CAB, 766 F.2d 1107, 1110 (7th Cir. 1985). This statement was plainly correct. If a CRS has no airline owner, no airline marketer, and no other affiliation with an airline, and does not sell air transportation, there is simply no basis for the Department to assert jurisdiction.⁸²

The Department invokes the concept of a level playing field, arguing that if some CRSs are regulated then all should be. The argument for equal treatment of all CRSs has some merit as a policy matter. However, if the Department lacks jurisdiction to regulate systems without an airline affiliation under the terms of the statute, it cannot use the level playing field argument to fill the gap.

**X. THE DEPARTMENT SHOULD PROMULGATE THE PROPOSED
FARE ADVERTISING RULE**

Section 399.84 of the Department's rules currently requires fare advertising by carriers and their agents to state the "entire price to be paid by the customer." 14 C.F.R. § 399.84. The Department proposes to amend this rule in two respects: first, to extend the rule to CRSs; and second, to require travel agencies, in any advertisement or solicitation, to state separately the service fees they charge. 67

⁸² Of course, CRSs that are not affiliated with an airline would not be free of regulatory controls just because the Department does not regulate them. The Justice Department and the Federal Trade Commission would have authority to enforce the antitrust laws against such CRSs, and the FTC could promulgate rules or bring enforcement actions against them under Section 5 of the Federal Trade Commission Act.

Fed. Reg. at 69428. Galileo supports both of these changes, although the language of the proposed rule needs clarification.

The fare advertising rule on its face does not appear to fit the circumstances of a CRS, because it speaks in terms of “advertising or solicitation.” The presentation of airline flight information to a travel agent in a CRS display is not ordinarily thought of as “advertising” or “solicitation” in the ordinary sense of those words.

However, requiring CRS fare displays to state the full fare to be paid by the customer, including all taxes, airport fees, and other charges borne by the customer (other than travel agency fees), makes sense in some cases. For example, when a travel counselor builds an itinerary in preparation for booking a flight, the CRS should be in a position to provide information on the full fare the customer would pay, based on the description the travel counselor enters (airports to be used, e-ticket versus paper ticket, etc.). (Of course, the CRS’s ability to list the relevant charges will depend on whether the airline has provided the proper information in a format that can be accepted by the CRS. CRSs should not be liable for errors made by carriers in their submission of information, unless the CRS has reason to know that the submission is inaccurate.)

In other cases, however, it would be impractical to require all charges to appear in a fare display. For example, agents (both online and offline) are often asked about the lowest fare between two cities. Rather than quote a fare for a specific itinerary, the travel counselor begins by generating a tariff display that shows all

available fares between the two cities.⁸³ At this stage, it would not even be possible to list all applicable charges, particularly those that are dependent on the actual flights and airports chosen for the final itinerary. Instead, the travel counselor would advise generally that certain charges might be added to the fares listed, depending on the itinerary selected by the traveler. The Department should make clear that this sort of preliminary fare display, which is not used in the actual building of an itinerary, would not be subject to the fare advertising requirements.

A requirement that travel agencies state service fees separately when advertising fares will benefit consumers. This information will allow consumers to make an informed choice about which travel providers to use in booking travel, and to compare the services a particular provider offers with the fees it charges for those services.

The proposed rule must be revised to avoid significant ambiguities and unintended consequences, however. As now proposed, new subsection (b) of the rule requires the agent to list separately its service fees, along with a statement of the entire price to be paid to the agent, but then adds the following proviso:

“(b) provided further, that such separate listing of a service fee will be considered an unfair and deceptive practice if the service fee is ad valorem in nature, if the fee exceeds the greater of \$20 or ten percent of the price for the air transportation, tour, or tour component, . . . “ 67 Fed. Reg. at 69428.

⁸³ Travel counselors at traditional travel agencies need access to such a display in order to provide efficient service to their customers. Online travel agencies presumably also need the ability to generate this sort of tariff display if it is requested by the consumer.

This proviso might be read to prohibit ad valorem fees or to impose a cap on the service fees a travel agency may charge, even though the NPRM does not discuss any basis for such an expansive regulation of prices. Alternatively, the proposed rule as drafted could be interpreted to require a separate listing of agency service fees, but to prohibit such separate listings if the service fees exceed the cap or are based on a percentage of the ticket cost. It is difficult to see what purpose such a provision would serve.

Based on the letter filed in this proceeding by ASTA,⁸⁴ we understand that the proposed rule is not intended to regulate prices in this way, or to prohibit disclosure of services fees at any level. Instead, the Department intends only to propose a level of fees for which more specific disclosures would be required. It is important to remove these ambiguities and to craft a rule that clearly reflects the Department's intentions. This could be accomplished by striking the language of the proviso quoted above and adopting a rule that requires travel agents to disclose, prominently and near the advertised fare, all agency service fees, no matter what level or method of computation.

XI. IF THE DEPARTMENT ADOPTS ITS PROPOSALS, THERE WILL BE SIGNIFICANT HARM TO COMPETITION AND CONSUMERS.

The Department's proposal for changes to the CRS rules would turn the current business model on its head for all industry participants. In particular, removal of the mandatory participation rule and the prohibition of discriminatory

⁸⁴ Letter to Thomas Ray from Paul M. Ruden on behalf of the American Society of Travel Agents, OST-1997-2881-299 (Nov. 14, 2002).

booking fees and introduction of a prohibition on productivity pricing are radical changes that will impose serious burdens on airlines not affiliated with a CRS (particularly low cost and smaller carriers), travel agents, and ultimately consumers. CRSs, particularly CRSs without airline affiliates, will be subject to anticompetitive conduct by airlines and will be cut off from important content. Ultimately, consumers will be deprived of information and services.

The winners under the proposed scheme will be the large airlines, particularly those with market power in fortress hubs. The losers will be smaller airlines, including new entrants and low cost carriers. As the large hub carriers gain greater share, and low cost carriers are marginalized or driven out of business, fares will rise. Again, consumers will be the losers.

Galileo agrees that it is generally preferable for commercial relationships to be governed by the free market, not by regulation. However, where there is a genuine need for regulation, there is no place for half-measures. If the Department adopts its proposals, there is a real threat that airlines affiliated with CRSs will withhold participation and inventory to disadvantage other systems, thereby increasing their dominance of airline markets.

CONCLUSION


For the reasons stated above, the Department should retain the mandatory participation provision and strengthen it to ensure that the rule protects against the full range of anticompetitive conduct by CRS-affiliated airlines. In addition, the Department should retain the prohibition on discriminatory booking

fees, and it should preserve the subscriber contract provisions unchanged. The Department should make clear that airline-owned Orbitz is covered by the rules because it is making its airline distribution services available to travel agents and functioning like a CRS, and should enforce the mandatory participation rule against the Orbitz owners. Finally, an effective regulatory framework should remain in effect so long as there are ownership or marketing relationships or similar affiliations between airlines and CRSs that create incentives for anticompetitive conduct.⁸⁵

Respectfully submitted,

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March 17, 2003

⁸⁵ For the reasons stated in its filing of January 3, 2003, Galileo renews its request for a fact hearing in connection with this rulemaking.

CERTIFICATE OF SERVICE

I hereby certify that I have, this 17th day of March 2003, caused to be served an electronic copy of the foregoing Comments of Galileo International in Response to Notice of Proposed Rulemaking and Appendix thereto on the persons whose e-mail addresses are listed below.


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